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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 518

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SABINE TRANSPORTATION COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR CERTIORARI FILED NOVEMBER 9, 1942
CERTIORARI GRANTED DECEMBER 14, 1942

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TRANSCRIPT OF RECORD.

UNITED STATES CIRCUIT COURT OF APPEALS,
FIFTH CIRCUIT.

SABINE TRANSPORTATION COMPANY, INC.,
Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition to Review the Decision of the United States Board of Tax Appeals.

DOCKET ENTRIES.

Sabine Transportation Company, Inc., Petitioner,
vs. Docket No. 103869.
Commissioner of Internal Revenue, Respondent.

Appearances.

For Taxpr.:
James H. Yeatman.

For Comm'r:
W. H. Payne.

1940.

July 22—Petition received and filed. Taxpayer notified. Fee paid.
July 22—Copy of petition served on General Counsel.
Aug. 20—Answer filed by General Counsel.

1940.

Aug. 20—Request for hearing in Houston, Texas, filed by General Counsel.

Aug. 28—Notice issued placing proceeding on Houston, Texas, calendar. Answer and request served.

Dec. 3—Hearing set January 6, 1941, in Houston, Texas.

1941.

Jan. 10—Hearing had before Mr. Smith on merits. Stipulation as to facts filed. Briefs due March 11, 1941. Reply briefs due March 26, 1941.

Feb. 1—Transcript of hearing January 10, 1941, filed.

Mar. 8—Brief filed by taxpayer. March 12, 1941, copy served on General Counsel.

Mar. 11—Brief filed by General Counsel.

Mar. 24—Reply brief filed by taxpayer.

May 26—Memorandum opinion rendered. Smith, #5. Decision will be entered for the respondent. March 26, 1941, copy served.

May 26—Decision entered. Smith, #5.

Aug. 8—Notice of the withdrawal of Wright Matthews as counsel filed.

Aug. 8—Notice of the appearance of James H. Yeatman as counsel filed.

Aug. 9—Petition for review by U. S. Circuit Court of Appeals, 5th Circuit, with assignments of error filed by taxpayer.

Aug. 21—Proof of service filed by taxpayer.

Sept. 4—Agreed praecipe filed. Proof of service thereon.

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2 PETITION.

July 22, 1940.

(Title Omitted.)

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commis-

sioner of Internal Revenue in his notice of deficiency (DALLAS, IRA:90D-H) dated June 25, 1940, and as a basis of its proceeding alleges as follows:

1. The petitioner is a Delaware corporation with principal office at Houston Avenue and Canal, Port Arthur, Texas. The return for the period here involved was filed with the collector for the first district of Texas.

2. The notice of deficiency (a copy of which is attached and marked Exhibit "A") was mailed to the petitioner on June 25, 1940.

3. The taxes in controversy are income taxes for the calendar year 1938 and in the amount of $13,250.00.

4. The determination of tax set forth in the said notice of deficiency is based upon the following error:

(a) Respondent failed to allow as a dividends paid credit the payment by petitioner during the year 1938 of $530,000.00 of indebtedness evidenced by notes which had been in existence prior to December 31, 1937.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) On December 28, 1937, in accordance with a resolution of the Board of Directors, petitioner executed and issued ten year, eight per cent notes aggregating $530,000.00 in payment of a dividend declared by the directors.

(b) During the calendar year 1938 said notes were retired by the payment in cash of $530,000.00 plus accrued interest to the date of payment.

(c) In accordance with the provisions of Section 27(a)(4) of the Internal Revenue Code, petitioner used the retirement of said notes as a dividends paid credit in its income tax return for the calendar year 1938.

Wherefore, the petitioner prays that this Board may hear the proceeding and determine that the payment of the $530,000.00 of notes during 1938 should be allowed as a dividends paid credit.

WRIGHT MATTHEWS,
(Wright Matthews),
Counsel for Petitioner.

Niels Esperson Building,
Houston, Texas.

State of Illinois,
County of Cook. ss.

F. J. Blaise, C. P. A., being first duly sworn, deposes and says that he is assistant Secretary and Assistant Treasurer of Sabine Transportation Company, the petitioner named in the foregoing petition, and as such is duly authorized to verify the foregoing petition; that he has read the foregoing petition and is familiar with the statements contained therein, and that the statements contained therein are true.

F. J. BLAISE.

Sworn to and subscribed before me this 16th day of July, 1940.

V. K. CRAYCROFT,
(Seal) Notary Public.

My Commission expires Dec. 31, 1940.

4 Treasury Department,
Internal Revenue Service,
June 25, 1940.

Office of
Internal Revenue Agent in Charge,
Dallas Division.

DALLAS IRA:90D-H.

Sabine Transportation Company, Inc.,
Post Office Drawer 1500,
Port Arthur, Texas.

Sirs:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1938 discloses a deficiency of $13,250.00 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned,

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to Internal Revenue Agent in Charge, 422 Federal Building, Dallas, Texas, for the attention of C:RLP. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest

period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,
GUY T. HELVERING,
Commissioner,
(Signed) By B. W. WILDE,
Internal Revenue Agent in Charge.

Enclosures:
Statement.
Form of waiver.

RTG:JW.

5 STATEMENT.

DALLAS IRA:90D-H.

Sabine Transportation Company, Inc.,
Post Office Drawer 1500,
Port Arthur, Texas.

Tax Liability for the Taxable Year Ended December 31, 1938.

	Liability	Assessed	Deficiency
Income Tax	$162,844.42	$149,594.42	$13,250.00

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated February 27, 1940; to your protest dated April 24, 1940; and to the statements made at the conference held on May 29, 1940.

A copy of this letter and statement has been mailed to your representative, Mr. Wright Matthews, 11th Floor, Esperson Building, Houston, Texas, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

Adjustments to Net Income.

Net income as disclosed by return		$875,179.22
Unallowable deductions and additional income:		
(a) 1937 operating expense	$ 1,464.40	
(b) Additional revenue	4,031.18	
(c) Capital expenditures	18,793.00	
(d) Depreciation	12,920.62	
(e) Capital stock tax	2,193.00	39,402.20
Total		$914,581.42
Nontaxable income and additional deductions:		
(f) Other income	$ 7,032.09	
(g) Maintenance expense	407.84	
(h) Administrative expense	4,670.88	12,110.81
Net income adjusted		$902,470.61

Explanation of Adjustments.

(a) to (h), inclusive. These items represent adjustments to which you have agreed, as evidenced by waiver form 870, executed under date of February 27, 1940.

Dividends paid credit claimed in the amount of $21,879.48, being 2½% of $875,179.22, the adjusted net income shown on your return, has been decreased by $13,254.48 to $8,625.00, it being held that the amount of $530,000.00, ten-year notes issued by you in December, 1937 in payment of a dividend declared in 1937 and allowed as divi-

dends paid credit in 1937, does not constitute a portion of the dividends paid in the year 1938 for the determination of the dividends paid credit in 1938, the year in which the notes issued in 1937 were paid.

Dividends paid credit claimed was determined as follows:

Cash dividends paid	$345,000.00
Dividend carry-over from 1937	22,405.45
Amount used to retire indebtedness	530,000.00
Total	$897,405.45
Adjusted net income	$875,179.22
Dividends paid credit claimed (2½% of $875,179.22)	$ 21,879.48
Dividends paid credit allowed: Cash dividends paid	$345,000.00
2½% of $345,000.00	$ 8,625.00

As the dividends paid credit for 1937 did not equal the undistributed adjusted net income for such year there was no dividends paid carry-over from 1937 to 1938.

Computation of Tax.

Income Tax.

Net income	$902,470.61
Adjusted net income	$902,470.61
Income tax at 19% on $902,470.61	$171,469.42
Less: Dividends paid credit (2½% of $345,000.00)	8,625.00
Correct income tax liability	$162,844.42

Income tax assessed:		
Original, account #400274	$144,404.57	
Additional, April 26, 1940 #529006	5,189.85	
Total assessed		149,594.42
Deficiency of income tax		$ 13,250.00

7 ANSWER.

Received Aug. 20, 1940.

Filed Aug. 20, 1940.

(Title Omitted.)

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition filed in the above-entitled appeal, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the calendar year 1938 for which the Commissioner has determined a deficiency in the amount of $13,250.00.

4.-(a) Denies that in determining the deficiency asserted against petitioner for the year in question the Commissioner committed error as alleged in subparagraph (a) of paragraph 4 of the petition.

5.-(a), (b) and (c). Denies each and every allegation contained in subparagraphs (a), (b) and (c) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified or denied.

Wherefore, it is prayed that the taxpayer's appeal be denied and that the determination of the Commissioner be approved.

(Signed) J. P. WENCHEL, TBS.
(J. P. Wenchel),
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
JAMES L. BACKSTROM,
Division Counsel,
WILFORD H. PAYNE,
Special Attorney,
Bureau of Internal Revenue.

WHP/ees-8-14-40.

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9 STIPULATION OF FACTS.

Jan. 10, 1941.

(Title Omitted.)

It is hereby stipulated and agreed by and between the parties hereto, through their respective counsel, that the following facts may be taken as true, subject to the right of either party to introduce other or further evidence not inconsistent therewith.

1. The petitioner is a Delaware corporation with its principal office located at Houston Avenue and Canal, Port Arthur, Texas. The return for the taxable year, in-

volved was filed with the Collector of Internal Revenue for the First Collection District of Texas, Austin, Texas.

2. The notice of deficiency, a true copy of which is attached to the petition herein, was mailed to petitioner on June 25, 1940.

3. The tax involved in this proceeding is the corporation income tax for the calendar year 1938, for which year the Commissioner has proposed a deficiency against petitioner in the amount of $13,250.00.

4. During the year 1937, petitioner declared and paid cash dividends of $30,000.00 on its outstanding common stock. In addition thereto further dividends, payable in obligations of the corporation, were authorized at a duly called meeting of petitioner's board of directors held December 28, 1937, at which the following action was taken:

"Sabine Transportation Company, Inc.
Copy of Dividend Resolutions other than Case.

We, the undersigned, being all the directors of Sabine Transportation Company, Inc., hereby waive notice of the time, place and purpose of a special meeting of the Board of Directors of said company, and consent that the same shall be held at the office of the Sabine Towing Company, Inc., in the city of Port Arthur, Texas, on Tuesday, December 28, 1937, at 10:00 o'clock A. M.

(Signed) C. B. WATSON,
(Signed) RAWLEIGH WARNER,
(Signed) D. D. IRWIN,
(Signed) M. T. BALL,
(Signed) L. L. ABSHIRE,
(Signed) R. P. SMITH,

Pursuant to the foregoing waiver of notice, a special meeting of the Board of Directors of Sabine Transportation Company, Inc., was held at the office of the Sabine Towing Company, Inc., in the City of Port Arthur, Texas, on Tuesday, December 28, 1937, at 10:00 o'clock A. M. Messrs. M. T. Ball, L. L. Abshire and R. P. Smith were present, and Messrs. C. B. Watson, Rawleigh Warner and D. D. Irwin were absent. The meeting was called to order by M. T. Ball, President, and L. L. Abshire, Secretary, acted as such.

The Chairman then presented the matter of the declaration of dividends upon the common stock of the company. Thereupon the following resolutions were presented, and on motion duly seconded and carried were adopted:

Resolved: that a dividend of Thirty-Five dollars and thirty-three and one-third cents ($35.33-1/3) per share upon all of the common stock of the company issued and outstanding be, and the same hereby is declared, payable to stockholders of record as of this date, as follows:

The Pure Oil Company	7,650 Shares	$270,300.00
Sabine Towing Company, Inc.	7,350 Shares	259,700.00
		$530,000.00

Such dividend shall be paid by the issuance and delivery of ten year eight per cent notes, dated December 28, 1937, aggregating the above amounts, to each of the respective stockholders, and issued in such denominations as the stockholders may elect; all of such notes being of equal priority and validity and the President and Treasurer of this Company are hereby authorized to execute and deliver such notes as provided herein, the amounts and denominations of such notes in accordance with the election

of the respective stockholders being shown in the following form:

Sabine Transportation Company, Inc.

Note.

No. ..... $.....

Dated December 28, 1937. Due December 28, 1947.

For value received Sabine Transportation Company, Inc., hereby promises to pay to the order of ....., in the office of the Company in Port Arthur, Texas, on the 28th day of December, 1947 ..... Dollars ($.....) and to pay interest thereon from December 28, 1937, at the rate of eight per cent (8%) per annum, payable semi-annually in equal installments on June 28 and December 28 of each calendar year until such principal sum shall be paid. This note is one of eight notes aggregating the total amount of $530,000.00 and numbered and in the amounts and payable as follows:

(1)	The Pure Oil Company	$270,300.00
(2)	Sabine Towing Company, Inc.	37,100.00
(3)	Sabine Towing Company, Inc.	37,100.00
(4)	Sabine Towing Company, Inc.	37,100.00
(5)	Sabine Towing Company, Inc.	37,100.00
(6)	Sabine Towing Company, Inc.	37,100.00
(7)	Sabine Towing Company, Inc.	37,100.00
(8)	Sabine Towing Company, Inc.	37,100.00

all notes being dated December 28, 1937, due December 28, 1947, bearing interest at the rate of eight per cent (8) per annum, beginning December 28, 1937, payable semi-annually, all of said notes being equal in priority and validity with respect to both principal and interest. On

default in payment of any semi-annual installment of interest on one or more of said notes described herein, the principal amount with accrued interest of all of said notes unretired shall become immediately due and payable without notice, which is hereby expressly waived.

The privilege is reserved by Sabine Transportation Company, Inc., of retiring this note or of paying any part thereof, without notice, on the first day of any calendar month by payment of the principal amount or any part thereof with interest to the date of retirement or part payment.

This note is negotiable, assignable and transferable by the payee in the usual manner, but in case of each transfer the transferor shall notify Sabine Transportation Company, Inc., at its office in Port Arthur, Texas, in writing, and until so notified, the maker hereof may treat the original payee or the last successive transferee of which it has notice, as the legal holder hereof for all intents and purposes, and payment of interest or principal to such holder shall fully discharge the maker hereof of all obligations in the premises.

SABINE TRANSPORTATION
COMPANY, INC.,

(Signed) By M. T. BALL,
President,

....,
Treasurer.

There being no further business to come before the meeting, it was adjourned.

(Signed) L. L. ABSHIRE,
Secretary.

Chicago, Illinois, ..., 1937.

Pursuant to Article III, Section (d) of the by-laws, whereby the action taken at directors' meetings at which not less than three members are present shall become effective and binding when approved in writing by not less than two additional members of the Board, the undersigned directors of Sabine Transportation Company, Inc., hereby signify that they have read the foregoing record of special meeting of directors held on Tuesday, December 28, 1937, at 10:00 o'clock A. M. in the office of the Sabine Towing Company, Inc., in the City of Port Arthur, Texas, and do hereby approve the action taken at such meeting.

(Signed) C. B. WATSON,
(Signed) RAWLEIGH WARNER,
(Signed) D. D. IRWIN."

Notes for the sum of $530,000.00 were duly issued in 1937 by petitioner to its stockholders of record as of December 28, 1937, in accordance with the provisions of the resolution.

5. In its corporation income and excess-profits tax return filed for the calendar year 1937, petitioner reported as distributions to its stockholders, out of earnings or profits of the taxable year or out of earnings or profits accumulated since February 28, 1913, the aforesaid cash dividends of $30,000.00 and the dividend paid in obligations of the corporation amounting to $530,000.00, or total distributions during the year of $560,000.00. Petitioner claimed in that return as dividends paid credit the following:

Taxable distributions (the sum of the above $30,000.00 and $530,000.00 dividends)	$560,000.00
Dividend carry-over from the preceding taxable year	81,562.60
Total dividends paid credit	$641,562.60

The undistributed profits surtax computation, as reflected in said return, was as follows:

Net income for income tax computation	$740,345.10
Normal tax	109,891.77
Adjusted net income	$630,453.33
Dividends paid credit	641,562.60
Undistributed net income	None
Total normal tax and surtax	$109,891.77

6. The only adjustments made by the Commissioner in petitioner's 1937 return related to items which are not material to the issue presented here. Additional income for the year 1937 was determined and a deficiency in normal tax in the amount of $2,256.43, and a deficiency in surtax on undistributed profits in the amount of $117.40 were asserted against petitioner and agreed to by it, or an aggregate additional income tax for that year of $2,373.83.

7. The ten-year dividend notes, aggregating $530,000.00 issued by petitioner under the foregoing resolution of December 28, 1937, were paid in cash by it during its taxable year 1938, as follows:

Date of Payment	The Pure Oil Co.	Sabine Transportation Co.	Total
1-31-38	$ 5,607.73	$ 5,387.82	$ 10,995.55
2-28-38	6,008.80	5,767.61	11,771.41
3-31-38	5,867.93	5,637.80	11,505.73
3-31-38	33,150.00	31,850.00	65,000.00
4-30-38	30,600.00	29,400.00	60,000.00
4-30-38	6,185.53	5,942.95	12,128.48
5-31-38	6,390.12	6,139.53	12,529.65
5-31-38	40,800.00	39,200.00	80,000.00

Date of Payment	The Pure Oil Co.	Sabine Transportation Co.	Total
6-29-38	39,895.38	38,330.84	78,226.22
7-30-38	14,640.05	14,065.92	28,705.97
8-30-38	24,940.90	23,962.82	48,903.72
9-29-38	56,218.56	54,014.71	110,233.27
Totals	$270,300.00	$259,700.00	$530,000.00

8. In its corporation income and excess-profits tax return filed for the year 1938, petitioner reported distributions to its stockholders and claimed dividends paid credit in the following amount:

Cash dividends declared and paid during the year	$345,000.00
Dividend carry-over from preceding taxable years	22,405.45
Amounts used to pay or to retire indebtedness	530,000.00
Dividends paid credit claimed	$897,405.45

The item of $530,000.00 above represents the ten-year dividend notes issued by petitioner in 1937, which were paid in 1938.

9. In the computation of its normal income tax, as reflected in its return for 1938, petitioner claimed as a credit the amount of $21,879.48, being two and one-half percent of the adjusted net income reported in the return amounting to $875,179.22, said amount being lower than the total dividends paid credit claimed of $897,405.45.

10. In determining petitioner's Federal income tax for the year 1938 the Commissioner increased taxable net income from $875,179.22 as reported in the return to $902,470.61, the details of which are set forth in the deficiency notice, which adjustments are not contested by petitioner. In computing the income tax liability the Commissioner disallowed that portion of the dividends paid credit consisting of the amounts used to pay the indebtedness of $530,000.00 and the amount representing the dividend carry-over from the preceding taxable years of $22,405.45 claimed in the return for 1938. In determining the resulting deficiency in tax, the Commissioner decreased the aforesaid credit of $21,879.48 claimed by petitioner by the amount of $13,254.48 to $8,625.00, the latter amount being two and one-half percent of the cash dividends of $345,000.00 paid during the year 1938. Petitioner does not contest the Commissioner's disallowance of the item claimed as a dividend carry-over of $22,405.45.

11. Thus the only question to be determined by the Board is whether, in computing its income tax for the taxable year 1938, petitioner is entitled, in the determination of the dividends paid credit, to use the sum of $530,000.00 as an amount used to pay or to retire indebtedness, said sum representing the amount paid in 1938 in the satisfaction of the ten-year dividend notes issued by petitioner in 1937.

12. If the Board should determine that the said item of $530,000.00 is not allowable in the determination of the dividends paid credit for the year 1938, then it is agreed that the correct deficiency in tax is the amount set forth in the deficiency notice. On the other hand, if the Board should conclude that payment of the aforesaid obligations in the year 1938, amounting to $530,000.00, must be taken into account, in whole or in part, in determining the dividends paid credit for that year, then it is agreed that the

resulting deficiency in tax may be computed under Rule 50 of the Board's Rules of Practice.

(Sgd.) WRIGHT MATTHEWS,
Counsel for Petitioner,

(Sgd.) J. P. WENCHEL, J. H. Y.
(J. P. Wenchel),
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

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18 MEMORANDUM OPINION.

(Title Omitted.)

Wright Matthews, Esq., for the petitioner.

Wilford H. Payne, Esq., for the respondent.

SMITH:

This is a proceeding for the redetermination of a deficiency in income tax for 1938 in the amount of $13,250. The question in issue is whether in computing its income tax for the taxable year 1938 the petitioner is entitled in the determination of the dividends paid credit to use the sum of $530,000 as an amount used to pay or to retire indebtedness, said sum representing the amount paid in 1938 in satisfaction of the 10-year dividend notes issued by the petitioner in 1937.

The facts have all been stipulated and are incorporated herein by reference as our findings of fact.

The petitioner is a Delaware corporation with its principal office in Port Arthur, Texas. It filed its income and excess-profits tax returns for 1937 and 1938 with the collector of Internal Revenue at Austin.

During 1937 the petitioner declared and paid cash dividends of $30,000 on its outstanding common stock. In addition thereto a further dividend of $35.33-1/3 per share upon all its common stock payable in obligations of the corporation was declared at a directors' meeting held December 28, 1937, and was payable to stockholders of record as of that date as follows:

	Shares	Amount
The Pure Oil Corporation	7,650	$270,300
Sabine Towing Co., Inc.	7,350	259,700
Total		$530,000

Pursuant to the terms of the resolution the dividend was paid by the issuance and delivery of petitioner's 10-year, eight percent notes due December 28, 1947, to each of the respective stockholders in the amounts stated aggregating the sum of $530,000.

In its Federal income and excess-profits tax return filed for 1937 the petitioner reported as distributions to its stockholders out of earnings and profits a cash dividend of $30,000 and the dividend paid in its obligations amounting to $530,000, or aggregate distributions for the year of $560,000. This amount, plus a dividend carry-over of $81,562.60, making a total of $641,562.60, was claimed in that return as a dividends paid credit. In the computation of the undistributed profits surtax, as reflected in the return, the deduction of the aggregate credit of $641,562.60 from the adjusted net income of $630,453.33, shown therein, left no undistributed net income. Certain adjustments were made by the respondent in the 1937 return with respect to other items which are not material to the issue involved in the instant proceeding. As a result thereof, a deficiency in normal tax of $2,256.43 and a deficiency in

surtax of $117.40 were asserted against petitioner and agreed to by it for the year 1937.

The 10-year dividend notes aggregating $530,000 issued in 1937 were paid in full by petitioner to its two stockholders, in cash, during the taxable year 1938, the year involved in this proceeding. In its return for 1938 the petitioner reported distributions to its stockholders and claimed dividends paid credit as follows:

Cash dividends declared and paid during the taxable year	$345,000.00
Dividend carry-over from preceding taxable years	22,405.45
Amounts used to pay or to retire indebtedness	530,000.00
Dividends paid credit claimed	$897,405.45

The item of $530,000, above, represents the 10-year dividend notes issued in 1937 and paid in 1938.

In determining petitioner's Federal income tax liability for 1938 the respondent disallowed that portion of the dividends paid credit, which had been claimed in the return, consisting of the amounts used to retire the indebtedness of $530,000. He also disallowed the amount representing the dividend carry-over of $22,405.45. The petitioner does not contest the respondent's disallowance of the item of dividend carry-over of $22,405.45.

The only question for the determination of the Board is whether in computing its income tax for the taxable year 1938 the petitioner is entitled, in the determination of the dividends paid credit, to include the sum of $530,000 as an amount used to pay or to retire indebtedness, that sum representing the amount paid in 1938 in satisfaction of the 10-year dividend notes issued by the petitioner in 1937.

The parties have stipulated that if the petitioner is not entitled to include in its dividends paid credit of 1938 the amount of $530,000, which was included in the dividends paid credit for 1937, the deficiency determined by the respondent for 1938 in the amount of $13,250 is correct.

The question presented by this proceeding is the same as that which was considered by the Board and ruled adversely to the taxpayer's contentions in *Spokane Dry Goods Co.*, 43 B. T. A. 793. In accordance therewith we hold that the petitioner is not entitled to include in its dividends paid credit for 1938 the $530,000 in question.

Decision will be entered for the respondent.

Entered: May 26, 1941.

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20 DECISION.

(Title Omitted.)

Pursuant to the determination of the Board, as set forth in its Memorandum Opinion, entered May 26, 1941, it is

Ordered and Decided: That there is a deficiency in income tax for the calendar year 1938 in the amount of $13,250.00.

(Signed) CHARLES P. SMITH,
(Seal) Member.

Enter: Entered May 26, 1941.

21 PETITION FOR REVIEW.

Filed Aug. 9, 1941.

(Title Omitted.)

To the Honorable Judges of said Court:

Now comes the petitioner, Sabine Transportation Company, Inc., by its attorney, James H. Yeatman (Vinson, Elkins, Weems & Francis), and files this, its petition for review, by the United States Circuit Court of Appeals for the Fifth Circuit, of the decision of the United States Board of Tax Appeals entered May 26, 1941.

Jurisdiction.

The petitioner is a Delaware corporation and has its principal office and place of business in Port Arthur, Texas. Petitioner's return for the calendar year 1938, the year in controversy, was filed with the Collector of Internal Revenue at Austin, Texas, which is within the Fifth Judicial Circuit of the United States.

On June 25, 1940, the respondent, in accordance with Section 27 (a) of the Revenue Act of 1938, advised the petitioner by registered mail that the determination of its income tax liability for the year ended December 31, 1938, disclosed a deficiency of $13,250.00. Thereafter the petitioner duly filed with the United States Board of Tax Appeals a petition for redetermination of the deficiency disclosed in the respondent's said letter of June 25, 1940, and the respondent duly filed an answer to the said petition. The proceeding was heard by the United States Board of Tax Appeals on January 10, 1941. The proceeding was submitted to the Board of Tax Appeals on a stipulation of facts, and on May 26, 1941, the Board of

Tax Appeals entered its decision that there is a deficiency in petitioner's income tax liability for the calendar year 1938 in the amount of $13,250.00.

The Nature of the Controversy.

The controversy between the parties is whether petitioner is entitled under Section 27 (a) (4) of the Revenue Act of 1938 to include in its dividends paid credit provided by said section the sum of $530,000.00 which it paid on its indebtedness during the year 1938. This indebtedness arose under the following circumstances:

On December 28, 1937, petitioner, acting through its Board of Directors, declared a dividend amounting to $530,000.00. This dividend was made payable in obligations of the petitioner, and on December 28, 1937, petitioner issued its ten year eight per cent (8%) promissory notes in the aggregate principal amount of $530,000.00 to its stockholders in payment of the dividend so declared.

The net income as disclosed by petitioner's return for 1938 was $875,199.22, and therein petitioner claimed under Section 27 of the Revenue Act of 1928 a dividends paid credit of $897,405.45, which was arrived at as follows:

Cash Dividends Declared and Paid During the Year	$345,000.00
Dividend Carry-Over from Preceding Taxable Years	22,405.45
Amount Paid on Indebtedness Represented by Notes Issued to Stockholders in 1937 in Payment of Dividends	530,000.00
Total	$897,405.45

and, as provided in Section 13 (c) (2) b of the Revenue Act, reduced its tentative normal tax by $21,879.40, said sum being two and a half per cent (2½%) of the adjusted net income of $875,179.22 shown on the return, said latter amount being lower than the total dividends paid credit claimed of $897,405.45.

The respondent made an audit of petitioner's return for the year 1938, and he increased the net income reported therein from $875,179.22 to $902,470.61. The adjustments resulting in said increase in income were conceded by the petitioner. In addition to increasing petitioner's taxable net income, the respondent in computing petitioner's dividends paid credit under Section 27 of the Revenue Act of 1938 excluded therefrom the aforesaid sum of $530,000.00, as well as the dividend carry-over from the preceding taxable years of $22,405.45, and allowed petitioner as a dividends paid credit only the amount of the cash dividend paid by petitioner during the year of $345,000.00.

Petitioner did not contest before the Board of Tax Appeals the disallowance of the credit of $22,405.45, representing the dividends paid credit carry-over from the preceding tax year. Petitioner did contest, however, the correctness of the Commissioner's determination in excluding from its dividends paid credit the sum of $530,000.00 which petitioner paid on its indebtedness during the year 1938. The Board of Tax Appeals held that the said $530,000.00 was not includable in petitioner's dividends paid credit for the year 1938. The only question at issue in this Court is whether the Board erred in so holding.

Designation of Court of Review.

The petitioner, Sabine Transportation Company, Inc., being aggrieved by the conclusions of law contained in the opinion of the Board of Tax Appeals, promulgated May

26, 1941, and by the final decision entered by it on May 26, 1941, pursuant to said opinion, desires to obtain a review thereof by the United States Circuit Court of Appeals for the Fifth Circuit.

Assignments of Error.

The petitioner's assignments of error are as follows:

I.

The Board of Tax Appeals erred in finding and deciding that the sum of $530,000.00 which petitioner used in 1938 to pay and retire the ten year notes which it gave to its stockholders in 1937 can not be used and is not includable in determining the amount of the "dividends paid credit" to which petitioner is entitled under Section 27 of the Revenue Act of 1938, in computing its income tax liability for said year.

II.

The Board of Tax Appeals erred in failing to find and decide that the sum of $530,000.00 which petitioner used in 1938 to pay and retire the ten year notes which it gave to its stockholders in 1937 is includable in determining the amount of the "dividends paid credit" to which petitioner is entitled under Section 27 of the Revenue Act of 1938, in computing its income tax liability for said year.

III.

The Board of Tax Appeals erred in redetermining and deciding that the sum of $530,000.00, which petitioner used in 1938 to pay or retire the indebtedness represented by the ten year notes given to its stockholders in 1937, is not includable in determining the amount of the "divi-

dends paid credit" to which petitioner is entitled for said year under Section 27 of the Revenue Act of 1938, and in finding and deciding that petitioner's tentative tax for 1938, computed in accordance with Section 13 of the Revenue Act of 1938, should not be reduced by two and one-half per cent (2½%) of said sum of $530,000.00 or $13,250.00 in arriving at its correct tax liability for said year.

IV.

The Board of Tax Appeals erred in redetermining that petitioner was liable for any deficiency in income tax for the year 1938.

V.

The Board of Tax Appeals erred in failing to redetermine that petitioner did not owe any deficiency in income tax for the year 1938.

Wherefore, petitioner prays that this Honorable Court may review said findings, opinion, decision and order of the United States Board of Tax Appeals and reverse and set aside the same, and that this Honorable Court direct the entry of decision by the said United States Board of Tax Appeals in favor of the petitioner, redetermining and finding that there is no deficiency in its income tax for the year ended December 31, 1938.

Petitioner prays for such relief as it is entitled to receive, and prays that the Clerk of the United States Board of Tax Appeals be directed to transmit and deliver to the Clerk of this Honorable Court certified copies of all documents necessary and material to the presentation of the foregoing petition for review as required by the Rules of this Honorable Court and by the Statutes made and pro-

vided, and petitioner prays for such other and further relief as is mete and proper in the premises.

SABINE TRANSPORTATION
COMPANY, INC., Petitioner,
By JAMES H. YEATMAN,
(James H. Yeatman),
Counsel for Petitioner.

c/o Vinson, Elkins, Weems & Francis,
11th Floor Esperson Bldg.,
Houston, Texas.

The State of Texas,
County of Harris. ss.

James H. Yeatman, being duly sworn, deposes and says that he is attorney of record for the petitioner and that as such attorney he is authorized to verify the foregoing petition for review and assignments of error; that he knows the contents of the foregoing petition for review and assignments of error; that to the best of his knowledge, information and belief the statements are true and the assignments of error are well taken and intended to be argued.

JAMES H. YEATMAN,

Subscribed and Sworn to before me this the 6th day of August, A. D. 1941.

(Seal)

HAZEL BAUER,
Notary Public in and for
Harris County, Texas.

28 Filed Aug. 21, 1941.

(Title Omitted.)

To Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Attorney for Respondent, Commissioner of Internal Revenue, Washington, D. C.

You are hereby notified that the petitioner, Sabine Transportation Company, did on the 9th day of August, 1941, file with the Clerk of the United States Board of Tax Appeals at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Fifth Circuit of the decision of the Board of Tax Appeals heretofore rendered in the above entitled cause. A copy of the petition for review and the assignments of error as filed is attached hereto and served upon you.

Dated this 11th day of August, A. D. 1941.

JAMES H. YEATMAN,
(James H. Yeatman),
Counsel for Petitioner.

c/o Vinson, Elkins, Weems & Francis,
11th Floor Esperson Bldg.,
Houston, Texas.

Personal service of the foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein is hereby acknowledged this the 13th day of August, 1941.

J. P. WENCHEL,
(J. P. Wenchel),
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

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PRAECIPE.

Filed Sept. 4, 1941.

(Title Omitted.)

To the Clerk of the United States Board of Tax Appeals:

You are hereby requested to prepare, certify and transmit to the Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, in connection with Petition for Review heretofore filed by the Petitioner in the above cause, as required by law and by the rules of said Court, copies, duly certified as correct, of the following records and documents:

1. The docket entries of the proceedings before the Board of Tax Appeals.

2. Pleadings before the Board of Tax Appeals as follows:

(a) Petition for redetermination including annexed copy of notice of deficiency.

(b) Answer of Respondent to petition for redetermination.

3. Stipulation of Facts entered into by the parties through Counsel.

4. Memorandum opinion of the Board of Tax Appeals.

5. Decision of the Board of Tax Appeals.

6. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

7. This Praecipe.

Dated this 4th day of Sept., 1941.

JAMES H. YEATMAN,
Attorney for Petitioner on Review.

VINSON, ELKINS, WEEMS & FRANCIS,
11th Floor Esperson Building,
Houston, Texas.

Personal service of the foregoing Praecipe is hereby acknowledged this 4th day of Sept., 1941, and agreed to.

J. P. WENCHEL, C. A. K.
Chief Counsel for the Bureau of Internal Revenue, Counsel for Respondent.

CERTIFICATE.

(Title Omitted.)

I, B. D. GAMBLE, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 31, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 16th day of Sept., 1941.

B. D. GAMBLE,
Clerk, United States Board of Tax Appeals.

(Seal)

That thereafter the following proceedings were had in said cause in the United States Circuit Court of Appeals for the Fifth Circuit, viz:

Argument and submission

Extract from the Minutes of May 28th, 1942

No. 10077

SABINE TRANSPORTATION COMPANY, INC.

versus

COMMISSIONER OF INTERNAL REVENUE

On this day this cause was called, and, after argument by James H. Yeatman, Esq., for petitioner, and Arthur A. Armstrong, Esq., Special Assistant to the Attorney General for respondent, was submitted to the Court.

Opinion of the court

Filed June 30, 1942

In the United States Circuit Court of Appeals for the Fifth Circuit

No. 10077

SABINE TRANSPORTATION COMPANY, INC., PETITIONER

versus

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review of Decision of the United States Board of Tax Appeals (District of Texas)

June 30, 1942

Before SIBLEY, HUTCHESON, and HOLMES, Circuit Judges

HUTCHESON, Circuit Judge: Submitted upon stipulation as to the facts,[1] the Board, following its decision in Spokane Drygoods

[1] In 1937, taxpayer, a Delaware Corporation having two stockholders, Pure Oil Corporation and Sabine Towing Company, Inc., declared and paid on its outstanding common stock, cash dividends of $30,000, and a further dividend of $530,000 by the issuance and delivery of its 10 year 8% notes. In its federal income and excess profits tax return for 1937 the petitioner reported

Co. v. Commissioner,[3] sustained the determination of the Commissioner that in computing its income tax for the taxable year 1938, the taxpayer was not entitled under 27 (a) (4),[4] to take a dividends paid credit for the $530,000 used to pay or retire the notes issued in 1937 as dividends paid on its obligation.

Taxpayer is here insisting, that by the plain mandate of the section it is entitled to the credit claimed and that both this and the Spokane Case were wrongly decided. The Commissioner, standing on the Spokane Case and on the regulation that case approved, insists that the order of the Board was right and must be affirmed. We do not think so. We think it clear; that the Spokane Case was wrongly decided by Board and court; that the dissenting opinion of Board member Hill, clearly and correctly stated the law of that case; and that in the Pacific Flush Tank Case,[5] the Board while in terms differentiating, in effect overruled its prior decision. We agree with what it there said. "The terms of the statute as applicable to the facts of this case, are so plain and unambiguous as to require in our opinion no resort to construction in order to ascertain its meaning. However, if it could be said that the application of the literal meaning of the statute leads to results which should be avoided, that is, the granting of a

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the cash dividends and the dividends paid in its obligations, and they were allowed as dividends paid credits." During the tax year, 1938, the year involved in this proceeding, the 10 year dividend notes were paid to its stockholders in cash and in its return for 1938, taxpayer reported these distributions to stockholders and claimed a dividends paid credit, under Sec. 27 (a) (4), Revenue Act of 1938, on account of the sums used to pay and retire them. Respondent disallowed the claim and taxpayer brought the matter to the Board.

[3] Section 27 of Revenue Act of 1936:

Sec. 27. Corporation Credit for Dividends Paid.

(a) Dividends Paid Credit in General.—For the purposes of this title, the dividends paid credit shall be the amount of dividends paid during the taxable year. * * *

(d) Dividends in Obligations of the Corporation.—If a dividend is paid in obligations of the corporation, the amount of the dividends paid credit with respect thereto shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. * * *

43 B. T. A. 793, Affd., 125 F. (2d) 895.

[4] "Sec. 27. Corporation Dividends Paid Credit:

"(a) Definition in General. As used in this title with respect to any taxable year the term 'dividends paid credit' means the sum of: (1) * * * (2) * * * (3) * * * and (4) 'Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness.' As used in this paragraph the term 'indebtedness' means only an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to and in existence at the close of business on such date. Where the indebtedness is for a principal sum, with interest no credit shall be allowed under this paragraph for amounts used or set aside to pay such interest."

[5] Pacific Flush Tank Co. v. Commissioner, 45 B. T. A. 69.

double tax benefit, and that this statute should be construed in the light of the purpose and intent of Congress in enacting same, we nevertheless * * * conclude that even if the allowance of the credit claimed here would result in duplicating in whole or in part a tax benefit to the petitioner, it nevertheless appears clear that Congress intended to and did expressly grant such credit. And we further conclude that Art. 27 (a) (3) of Regulations 101, purporting to deny such credit is contrary to the statute and is therefore a nullity as applied to the facts of this case."

We think it clear that in attempting, by speculating as to what Congress intended to do except as that intent was expressed in the statute, to rationalize out of the section the comprehensive words which specifically grant the deduction, the Commissioner is attempting to have us arrogate to ourselves the function of rewording rather than of construing and applying the statute.[5] The construction of a statute to make it carry out the intent its words import is one thing. The construction of it to bring it nearer to the thought of administrator or court, or of some particular section of public opinion, as to what Congress intended or ought to have intended, or that the law would better serve its purpose if it were drawn that way,[6] is quite another. However, we need not further labor the point here, for in *Helvering v. Credit Allowance Association*, April 27, 1942, — U. S. —, the Supreme Court, rejecting the same kind of reasoning as to a dividends paid credit claimed under Section 27 (b) of the Revenue Act of 1936, and declaring invalid a regulation which contravened the plain terms of the statute, has set the matter at rest. Definitely reaffirming the principle that it is for the courts not to write but to enforce a statute,

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[5] "Courts and Administrative agencies are bound to enforce the plain words of the statute although there may be reason to think in view of the general legislative purpose that some other provision would have met with favor, if the legislature had called it to mind." Commissioner of Internal Revenue v. Windrow, 89 F. (2d) (9, 110 A. L. R. 1251.

[6] "A legislative act in the United States is not as in some countries, a mere general outline by a party or group in power, of the purposes it wishes to accomplish, to be expanded, implemented and given effect by its administrators in accordance with the general purposes of its proponents. A fundamental fact in American political life has always been that in the struggle here for laws as means, to make law as liberator effective, there have always been differing opinions, as to the wisdom, propriety and scope of proposed new and controversial laws. Laws as finally enacted here, are usually the result of a compromise, or at least of an adjustment of these conflicting views.

"Because this is and always has been so, it can be usually said of our laws, that the general, not the partial or partisan will, speaks in them. It is because this is so, that canons of statutory interpretation and construction require that statutes must be construed and given effect, in accordance with the language chosen for the expression, of this compromise and adjustment of views, and not in accordance with the purposes or views, of either the proponents or the opponents of the legislation, which have not been given expression in the statute." Fleming v. Belo, 121 F. (2d) @ 212-13, Affd. June 9, 1942, — U. S. —.

the court said: "But we cannot, as the Government suggests, read into the section, as it stood when the transaction took place, an intent derived from the policy disclosed by the subsequent amendment. We shall not burden this opinion by extended reference to the legislative history of the Act of 1936. It is enough to say that it is inconclusive and, to some extent, supports the arguments of both parties. But whatever may be said of the policy behind the statute's provisions, we are not at liberty to disregard the direct and unambiguous language of subsection (f)." The principal there announced has controlling force here. Congress, for reasons of its own, in working out a compromise or adjustment, of the very controversial questions raised by the policy of, in effect, taxing corporations on dividends unpaid and of allowing them credits on those paid or what was regarded as the equivalent, drew the dividends paid statutes in the terms in which we find them. The taxpayer, conforming to the statute, paid dividends in its obligations in 1937. Still conforming to the statute it paid these obligations in 1938 and claimed the dividends credit the statute allowed, for the payment or retirement of "indebtedness of any kind." It is not for the commissioner or the courts to deny the taxpayer the deduction that Congress has granted him. The order is reversed and the cause is remanded for further and not inconsistent proceedings.

Reversed and remanded.

Judgment

Extract from the Minutes of June 30th, 1942

No. 10077

SABINE TRANSPORTATION COMPANY, INC.

versus

COMMISSIONER OF INTERNAL REVENUE

This cause came on to be heard on the petition of Sabine Transportation Company, Inc., for a review of a decision of the United States Board of Tax Appeals, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court, that the order of the said United States Board of Tax Appeals in this cause be, and the same is hereby, reversed; and that this cause be, and it is hereby, remanded to the said United States Board of Tax Appeals for further and not inconsistent proceedings.

Order denying rehearing

Extract from the Minutes of August 13th, 1942

No. 10077

SABINE TRANSPORTATION COMPANY, INC.

versus

COMMISSIONER OF INTERNAL REVENUE

It is ordered by the Court that the petition for rehearing filed in this cause be, and the same is hereby, denied.

Clerk's certificate

UNITED STATES OF AMERICA,
United States Circuit Court of Appeals, Fifth Circuit

I, Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, do hereby certify that the pages numbered from 33 to 44 next preceding this certificate contain full, true, and complete copies of all the pleadings, record entries, and proceedings, including the opinion of the United States Circuit Court of Appeals for the Fifth Circuit, in a certain cause in said Court, numbered 10077, wherein Sabine Transportation Company, Inc., is petitioner, and Commissioner of Internal Revenue is respondent, as full, true and complete as the originals of the same now remain in my office.

I further certify that the pages of the printed record numbered from 1 to 32 are identical with the printed record upon which said cause was heard and decided in the said Circuit Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of the said United States Circuit Court of Appeals, at my office in the City of New Orleans, Louisiana, in the Fifth Circuit, this 28th day of October, A. D. 1942.

OAKLEY F. DODD,
Clerk of the United States Circuit Court of Appeals, Fifth Circuit.

U. S. GOVERNMENT PRINTING OFFICE: 1942

Supreme Court of the United States

No. 518, October Term, 1942

Order allowing certiorari

Filed December 14, 1942

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ:

U. S. GOVERNMENT PRINTING OFFICE: 1942

FILE COPY

Office - Supreme Court, U. S.
FILED
NOV 9 1942
CHARLES ELMORE CROPLEY
CLERK

No. 518

In the Supreme Court of the United States

OCTOBER TERM, 1942

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SABINE TRANSPORTATION COMPANY, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

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In the Supreme Court of the United States

OCTOBER TERM, 1942

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SABINE TRANSPORTATION COMPANY, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit entered on June 30, 1942.

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 19–22) is unreported. The opinion of the Circuit Court of Appeals (R. 33–36) is reported at 128 F. (2d) 945.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 30, 1942. A petition for re-

hearing was filed on July 18, 1942 (within 21 days after entry of judgment, as required by the court's rules), and denied August 13, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

In 1937 taxpayer declared and paid a dividend in its own notes for the face amount of which it claimed and was allowed a credit in the computation of its undistributed profits tax for that year. Did Section 27 (a) (4) and 27 (e) of the Revenue Act of 1938 entitle the taxpayer to a second dividends paid credit with respect to the identical notes in 1938 when they were redeemed?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 6–9.

STATEMENT

The facts as stipulated (R. 10–19) were adopted by the Board of Tax Appeals as its findings (R. 19). They may be summarized as follows:

Taxpayer is a Delaware corporation with its principal office in Texas. It has only two stockholders. In 1937 it paid dividends of $30,000 in cash and $530,000 in its own ten-year 8 percent notes. For undistributed-profits-tax purposes, in its return for 1937 taxpayer claimed a dividends

paid credit of $641,562.60, consisting of the cash and also of the full face amount of the notes paid out as dividends, plus a dividend carry-over from the previous year. The Commissioner allowed this credit, but made adjustments in other items reported in the return, not here material, with a resulting deficiency in normal tax of $2,256.43 and in undistributed profits surtax of $117.40, to which taxpayer agreed. (R. 19–21.)

In 1938 taxpayer paid its two stockholders the full face amount of the dividend notes, and retired them. In its return for 1938 taxpayer claimed a second credit of the full face amount of these notes, this time under Section 27 (a) (4) of the 1938 act, dealing with amounts used to retire indebtedness incurred before the beginning of that year. The Commissioner disallowed the credit for 1938, and was sustained by the Board. (R. 21–22.) The taxpayer appealed, and the Circuit Court of Appeals reversed (R. 36).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In allowing the taxpayer a second credit upon the redemption of notes in 1938, which in 1937 when they were issued had been the occasion of a dividends paid credit equal to their full face amount.

(2) In reversing the decision of the Board of Tax Appeals.

REASON FOR GRANTING THE WRIT

As recognized by the court below (R. 34), its decision is in direct conflict with *Spokane Dry Goods Co.* v. *Commissioner,* 125 F. (2d) 865 (C. C. A. 9th). Also, the decision invalidates a reasonable administrative interpretation of the statute contained in Article 27 (a)–3 of Treasury Regulations 101.

The Government argued below that subsection (e) of Section 27 of the Revenue Act of 1938, which deals specifically with the credit allowable on the redemption of obligations previously issued in payment of dividends, controlled over the more general terms of subdivision (a) (4) of Section 27. The court below, however, gave effect only to the latter provision, which deals generally with the redemption of obligations, and denied effect both to the provision specifically dealing with redemptions of the type herein involved, and to the Treasury regulation. In conseqeunce the court below allowed a second credit in 1938 on account of an obligation which had already been the subject of a full credit in the previous year at the time of its issuance: an extraordinary result which alone might have suggested the view of congressional intent adopted in the regulation.

The Circuit Court of Appeals for the Ninth Circuit, on the other hand, took the view that the specific provisions of subsection (e) of Section 27

prevailed over the general terms of subdivision (a) (4) of Section 27, and upheld the regulation.

Though the issue cannot arise in the future under the existing revenue law, the question is nevertheless presented in a number of other cases pending in or which would go to circuit courts of appeals other than those which have already considered it.[1] Accordingly, the conflict should be resolved.

CONCLUSION

It is respectfully submitted that this petition should be granted.

CHARLES FAHY,
Solicitor General.

NOVEMBER 1942.

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[1] The following cases involving the question are pending on taxpayers' appeals in the Circuit Court of Appeals for the Seventh Circuit: *Journal Co.* v. *Commissioner*, 46 B. T. A. 841; *Jos. Schlitz Brewing Co.* v. *Commissioner*, decided April 30, 1942 (Prentice-Hall B. T. A. Memorandum Service, par. 42,239); *Winchester Repeating Arms Co.* v. *Commissioner*, decided August 28, 1941 (Prentice-Hall B. T. A. Memorandum Service, par. 41,404). The question has been decided for the Commissioner in *Noble Drilling Co.* v. *Jones*, by the District Court for the Western District of Oklahoma (decision rendered June 27, 1942, not officially reported but found in 1942 Prentice-Hall, par. 62879; motion for rehearing under consideration by the court). The question is pending in *Midland Broadcasting Co.* v. *United States*, awaiting trial in the District Court for the Western District of Missouri.

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 13. TAX ON CORPORATIONS IN GENERAL.

(a) *Adjusted Net Income.*—For the purposes of this title the term "adjusted net income" means the net income minus the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation the net income of which is more than $25,000 (except a corporation subject to the tax imposed by section 14, section 231 (a), Supplement G, or Supplement Q) a tax computed under subsection (c) of this section or a tax computed under subsection (d) of this section, whichever tax is the lesser.

(c) *General Rule.*—The tax computed under this subsection shall be as follows:

(1) A tentative tax shall first be computed equal to 19 per centum of the adjusted net income.

(2) The tax shall be the tentative tax reduced by the sum of—

(A) 16½ per centum of the credit for dividends received provided in section 26 (b); and

(B) 2½ per centum of the dividends paid credit provided in section 27, but not to exceed 2½ per centum of the adjusted net income.

* * * * *

SEC. 27. CORPORATION DIVIDENDS PAID CREDIT.

(a) *Definition in General.*—As used in this title with respect to any taxable year the term "dividends paid credit" means the sum of:

(1) The basic surtax credit for such year, computed as provided in subsection (b);

* * * * *

(4) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness. As used in this paragraph the term "indebtedness" means only an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to, and in existence at, the close of business on such date. Where the indebtedness is for a principal sum, with interest, no credit shall be allowed under this paragraph for amounts used or set aside to pay such interest.

(b) *Basic Surtax Credit.*—As used in this title the term "basic surtax credit" means the sum of:

(1) The dividends paid during the taxable year, increased by the consent dividends credit provided in section 28, and reduced by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations;

* * * * *

(e) *Dividends in Obligations of the Corporation.*—If a dividend is paid in obligations of the corporation, the amount with respect thereto which shall be used in computing the basic surtax credit shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. If the fair market value of any such dividend paid in any taxable year of the corporation beginning after December 31, 1935, is lower than the face value, then when the obligation is redeemed by the corporation in a taxable year of the corporation beginning after December 31, 1937, the excess of the amount for which redeemed over the fair market value at the time of the dividend payment (to the extent not allowable as a deduction in computing net income for any taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

ART. 27 (a)–3. *Amounts used or irrevocably set aside to pay or to retire indebtedness.*—(a) *Indebtedness.*—

* * * * * *

Double credits are not permitted, either for the same year or for separate years. Thus, amounts which have been or may be properly taken as a credit pursuant to section 27 (e) of the Act or section 27 (d) of the Revenue Act of 1936 (both sections relating to dividends in obligations of the corporation) may not again be included in the dividends paid credit under section 27 (a) (4) when the obligations are paid. No credit may be allowed under section 27 (a)

(4) for amounts used or irrevocably set aside to pay or retire indebtedness which represents an item which is allowable as a deduction from gross income, either for the same year or a different year. Thus the aggregate of the credits allowable under section 27 (a) (4) for amounts used or irrevocably set aside to pay or to retire obligations issued at a discount may not exceed the issue price of such obligations.

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No. 518

In the Supreme Court of the United States

OCTOBER TERM, 1942

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SABINE TRANSPORTATION COMPANY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE PETITIONER

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 19–22) is unreported. The opinion of the Circuit Court of Appeals (R. 33–36) is reported at 128 F. 2d 945.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 30, 1942. (R. 36.) A petition for rehearing was filed on July 18, 1942, and denied August 13, 1942. (R. 37.) A petition for a writ of certiorari was filed on November 9, 1942.

and granted on December 14, 1942. The jurisdiction of this Court is conferred by Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

In 1937 taxpayer declared and paid a dividend in its own notes for the face amount of which it claimed and was allowed a credit in the computation of its undistributed profits tax for that year. Did Section 27 (a) (4) and (e) of the Revenue Act of 1938 entitle the taxpayer to a second dividends paid credit upon redemption of the identical notes in 1938?

STATUTES AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 15–21.

STATEMENT

The facts as stipulated (R. 10–19) were adopted by the Board of Tax Appeals as its findings (R. 19). They may be summarized as follows:

Taxpayer is a Delaware corporation with its principal office in Texas. It has only two stockholders. In 1937 it paid dividends of $30,000 in cash and $530,000 in its own ten-year eight per cent notes. For undistributed profits tax purposes, in its return for 1937 taxpayer claimed a dividends paid credit of $641,562.60, consisting of the cash and also of the full face amount of the notes

paid out as dividends, plus a dividend carry-over from the previous year. The Commissioner allowed this credit, but made adjustments in other items reported in the return, not here material, with a resulting deficiency in normal tax of $2,256.43 and in undistributed profits surtax of $117.40, to which taxpayer agreed. (R. 19–21.)

In 1938 taxpayer paid its two stockholders the full face amount of the foregoing dividend notes, and retired them. In its return for 1938 taxpayer claimed a second credit of the full face amount of these notes, this time under Section 27 (a) (4) of the Revenue Act of 1938, dealing with amounts used to retire indebtedness incurred before the beginning of that year. The Commissioner disallowed the credit for 1938 because of Section 27 (e) of the 1938 Act and Article 27 (a)–3 of Treasury Regulations 101. He was sustained by the Board. (R. 21–22.) The taxpayer appealed, and the Circuit Court of Appeals reversed. (R. 36.)

SPECIFICATION OF ERRORS

The Circuit Court of Appeals erred:

(1) In allowing the taxpayer a second credit upon the redemption of notes in 1938, which in 1937 when they were issued had been the occasion of a dividends paid credit equal to their full face amount.

(2) In reversing the decision of the Board of Tax Appeals.

SUMMARY OF ARGUMENT

Both the Revenue Act of 1936 and the Revenue Act of 1938 provide for a surtax upon undistributed corporate profits. In the computation of undistributed corporate income subject to surtax, each statute allows a credit for dividends paid, and special credits in certain circumstances where dividends are difficult or impossible. Each statute contains a provision for the credit allowable when dividends are paid in the corporation's own bonds or notes. Revenue Act of 1936, Section 27 (d); Revenue Act of 1938, Section 27 (e). The total amount of the credit allowable is equal to the total amount of the dividend paid; but a portion of the credit, equal to the market or face value of the notes, whichever is less, is allowed in the year of the issuance of the notes. The portion allowable in the year of the redemption of the notes is limited to the excess of the redemption price over the fair market value of the notes when issued, and is permitted only if that fair market value was less than face value. In the instant case, the fair market value of the dividend notes when issued was equal to their face value; and the taxpayer received a credit for the full face amount of the notes in the year of issuance. Accordingly, it is not entitled to any credit in the year of redemption.

Section 27 (a) (4) may not be invoked to obtain the credit because it is a general provision

dealing with the redemption of indebtedness of all kinds, and is here controlled by the special provision, Section 27 (e), which deals with the redemption of *dividend obligations*. The Treasury regulation which so provides is a valid administrative interpretation supported by several accepted canons of statutory construction, *viz.*: The rule that a special statutory provision controls an inconsistent general one; the rule that a harmonious statutory scheme should be sought and absurd results avoided; the rule that double deductions should not be allowed; and the rule that credit provisions of this type must be strictly construed.

ARGUMENT

SECTION 27 OF THE REVENUE ACT OF 1938 DOES NOT AUTHORIZE A CREDIT FOR THE RETIREMENT OF NOTES, WHICH WOULD DUPLICATE A CREDIT PREVIOUSLY ALLOWED UPON THE ISSUANCE OF THE NOTES IN PAYMENT OF A DIVIDEND

In 1937 taxpayer paid a dividend in its own promissory notes. In its income tax return for that year it claimed a dividends paid credit for the full face amount of the dividend notes issued. The Commissioner allowed the credit, which was fully used in reduction of the tax. These notes were redeemed in 1938. The taxpayer claimed a second dividends paid credit in its 1938 return. This the Commissioner disallowed. The Board sustained him, relying upon its own decision in

Spokane Dry Goods Co. v. *Commissioner*, 43 B. T. A. 793,[1] which was subsequently affirmed by the Circuit Court of Appeals for the Ninth Circuit, 125 F. (2d) 685.[2] The decisions of the Board and the Circuit Court of Appeals for the Ninth Circuit are in agreement with the terms of Article 27 (a)–3 of Treasury Regulations 101 (Appendix, *infra* p. 19), which is submitted to be a valid administrative interpretation of the pertinent Section 27 (a) (4) and (e) of the Revenue Act of 1938 (Appendix, *infra* pp. 16, 17). However, the Circuit Court of Appeals for the Fifth Circuit reversed the Board of Tax Appeals in the instant case and invalidated the Treasury regulation. We submit that the decisions of the Board and Circuit Court of Appeals for the Ninth Circuit are correct, and that the decision of the court below in the instant case is wrong.

1. Both the Revenue Act of 1936 and the Revenue Act of 1938 imposed a tax on undistributed corporate profits. Under the Revenue Act of 1938 this was accomplished by the computation of a tentative tax of 19 per cent of adjusted net income which was then reduced by two and one-half

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[1] This decision was rendered by the full Board with three members dissenting.

[2] The following decisions are also in the Commissioner's favor: *Journal Co.* v. *Commissioner*, 46 B. T. A. 841; *Jos. Schlitz Brewing Co.* v. *Commissioner*, decided April 30, 1942 (Prentice-Hall B. T. A. Service, par. 42,229); *Noble Drilling Co.* v. *Jones* (W. D. Okla.), decided June 27, 1942 (1942 Prentice-Hall, par. 62,879).

per cent of the so-called "dividends paid credit" (but not to exceed two and one-half per cent of adjusted net income). Section 13 (c), Appendix, *infra*, p. 15. The dividends paid credit consisted primarily of the amount of earnings distributed to the stockholders, but included certain special credits in situations where the payment of dividends was difficult or impossible. Section 27. Thus in effect the 1938 statute imposed a tax of 16½ per cent upon adjusted net income, and a surtax of two and one-half per cent upon *undistributed* adjusted net income.

This 1938 surtax was the successor to the undistributed profits surtax imposed by Section 14 of the Revenue Act of 1936 (Appendix, *infra* pp. 17, 18), where the rates were higher and were graduated according to the percentage of adjusted net income remaining undistributed. The 1936 Act also provided for a dividends paid credit and for certain special credits, to be allowed in the computation of undistributed adjusted net income. Sections 26 (c) and 27, Appendix, *infra*, pp. 18, 19.

Each of these Revenue Acts allowed a credit upon the payment of dividends in the corporation's own promissory notes. Revenue Act of 1936, Section 27 (d), Appendix, *infra*, p. 19; Revenue Act of 1938, Section 27 (e), Appendix, *infra* p. 17. Under both statutes, however, the credit allowable at the time of issuance of dividend notes was equal to their fair market value or face value,

whichever was less. And it was further provided that where the notes were subsequently redeemed for more than their market value at the date of issuance, the excess would be allowable as a credit in the year of redemption. Section 27 (e) of the 1938 Act is in this respect carefully dovetailed with Section 27 (d) of the 1936 Act, since it refers to redemptions in taxable years beginning after December 31, 1937, of dividend notes issued in taxable years beginning after December 31, 1935.[3]

In the instant case the taxpayer was allowed a credit for the full face amount of its dividend notes when they were issued in 1937; apparently they were then worth par. In 1938 the notes were redeemed at their face value. Since this had been their market value and the amount for which credit had been allowed at the time of their issuance in 1937, it was implicit in Section 27 (e) of the 1938 Act (as it had been in Section 27 (d) of the 1936 Act) that no redemption credit was allowable in 1938. The theory of both statutes was that the corporation should be entitled to one full credit for the amount of a dividend paid; but if the actual distribution of cash or property was anticipated by the issuance of the corporation's own bonds or notes, that credit might be wholly or partly allowed in the year of issuance of the

[3] The 1936 Act governs computation of income tax for taxable years beginning after December 31, 1935; and the 1938 Act governs taxable years beginning after December 31, 1937. See Section 1 of each Act.

obligations. Only such part as was not allowed in the earlier year was deemed available in the year of redemption.

If there were no other statutory provisions touching the present subject, the Treasury's position would seem to be correct beyond dispute. But the taxpayer claims the 1938 credit not under subsection (e) of Section 27 of the 1938 Act, but under subdivision (a) (4). Section 27 (a) (4) allows a credit for amounts used or irrevocably set aside "to pay or to retire indebtedness of any kind," evidenced by bonds or notes issued before December 31, 1937, "if such amounts are reasonable with respect to the size and terms of such indebtedness." It is the Treasury's position that of these two closely associated and on casual inspection inconsistent provisions,[4] both dealing

[4] Actually they are not inconsistent. Section 27 (a) (4) must be read with the principle in mind that double deductions are not permitted in the absence of clear evidence that Congress intended to allow them (*Ilfeld Co.* v. *Hernandez*, 292 U. S. 62, 68). So read, it does not authorize this double deduction, even standing alone and without taking meaning from Section 27 (e). A limitation against being construed to allow double deductions or credits is implicit throughout Section 27 (a) (4). It allows a creditor deduction for amounts "used or irrevocably set aside" to retire indebtedness; yet certainly it does not permit an amount irrevocably set aside in one year and paid in the next year to be the subject of an undistributed profits tax credit on each occasion. This limitation is not express but is implied from the assumption that Congress did not intend to authorize double credits. The same implication may be drawn in the case at bar for the same reason.

with the redemption of corporate obligations, Section 27 (e) must control here. Section 27 (a) (4) is a general provision relating to indebtness of any kind, but Section 27 (e) is a special provision carving out for particular treatment indebtedness incurred by the payment of dividends in a corporation's own obligations. In accord with the familiar canon of construction, the specific provision must control the general one. *United States* v. *Chase,* 135 U. S. 255, 260; *Rodgers* v. *United States,* 185 U. S. 83, 89; *Baltimore Nat. Bank* v. *Tax Comm'n,* 297 U. S. 209, 215.

Furthermore, to apply Section 27 (a) (4) in cases of this type leads to absurd results. The basic statutory scheme is to impose an additional tax upon corporate earnings which remain with the corporation, but not to tax those earnings if they are distributed and thereby become subject to tax in the hands of the stockholders.[5] To allow one credit for the amount of earnings distributed as a dividend carries out the purpose exactly. But the application of Section 27 (a) (4) to dividend obligations permits the same dividend to give rise to two complete credits in two separate years, and hence frustrates the basic purpose of the statute. When the dupli-

[5] See Message of the President to Congress, March 3, 1936, H. Doc. No. 418, 74th Cong., 2d sess., pp. 2–3; H. Rep. No. 2475, 74th Cong., 2d sess., pp. 3–5 (1939–1 Cum. Bull. (Part 2) 667, 669–670).

cating credit is allowed, the taxpayer is permitted to accumulate an equivalent amount of earnings free of the additional tax.

An even more incongruous consequence logically follows from the application of the taxpayer's theory to facts somewhat different from those in the instant case. If a corporation paid a 1937 dividend in notes worth 75 percent of par, and redeemed the notes at par in 1938, not only would that corporation receive credits aggregating 200 percent of the dividend declared, but, even more astonishing, it would receive a credit of 125 percent of the dividend in the year 1938 alone. Under Section 27 (a) (4) it would receive a credit for the full face amount of the notes retired, and under Section 27 (e) a credit for the excess of the retirement price over the fair market value when issued.

The taxpayer's theory thus violates three accepted canons of construction, in addition to the one already mentioned (that a specific statutory provision controls a general one), namely, the rule that absurd results should be avoided in the interests of a reasonable and logical scheme based upon all of the provisions of the statute read together (*Haggar Co.* v. *Helvering,* 308 U. S. 389, 394; *Armstrong Co.* v. *Nu-Enamel Corp.,* 305 U. S. 315, 332–333; *Helvering* v. *N. Y. Trust Co.,* 292 U. S. 455, 464); the rule that double deductions are to be avoided (*Ilfeld Co.* v. *Hernandez,* 292 U. S. 62, 68; *McLaughlin* v. *Lumber Co.,* 293 U. S. 351, 355;

United States v. *Ludey*, 274 U. S. 295, 301); and the rule that credit provisions of this type are to be construed strictly (*Helvering* v. *Northwest Steel Mills*, 311 U. S. 46, 49; *Helvering* v. *Ohio Leather Co.*, Nos. 40–42, this Term).

The opinion of the court below does not discuss or even cite the crucial statutory provision, Section 27 (e) of the 1938 Act. And although it sets out the first sentence of Section 27 (d) of the 1936 Act in a footnote, it stops short of the second and critical sentence dealing with the credit allowable upon the redemption of dividend notes.* Indeed, a reading of the opinion below would lead one to suppose that there was no statutory provision involved here except Section 27 (a) (4).

2. When Section 27 (e) of the 1938 Act and its predecessor provision are taken into account, it certainly cannot be said, as the court below has done, that the taxpayer's right to the credit under Section 27 (a) (4) is clear. If the contrary is not clear, then at most there is a statutory ambiguity and a proper field for the exercise of admin-

*The court also mistakenly thought that *Pacific Flush-Tank Co.* v. *Commissioner*, 45 B. T. A. 869, was inconsistent with the Board's decision herein. In the *Pacific Flush-Tank* case the Board did not permit double undistributed profits tax credits; the Board merely held that a taxpayer which had secured an ordinary income tax deduction when it issued notes in payment of salaries was entitled to an undistributed profits tax credit later when the notes were redeemed. Furthermore, Section 27(e) was not involved in the *Pacific Flush-Tank* case.

istrative discretion. That discretion was exercised by Article 27 (a) (3) of Treasury Regulations 101, promulgated under the Revenue Act of 1938, wherein it is stated—

> Double credits are not permitted, either for the same year or for separate years. Thus, amounts which have been or may be properly taken as a credit pursuant to section 27 (e) of the Act or section 27 (d) of the Revenue Act of 1936 (both sections relating to dividends in obligations of the corporation) may not again be included in the dividends paid credit under section 27 (a) (4) when the obligations are paid.
> * * *

Certainly this administrative interpretation was not plainly wrong. On the contrary, it gave the only plausible and reasonable construction to the language of the two statutory provisions involved. Consequently it should have been sustained by the Circuit Court of Appeals. *Magruder* v. *Washington, B. & A. Realty Corp.*, 316 U. S. 69; *Fawcus Machine Co.* v. *United States*, 282 U. S. 375; *Brewster* v. *Gage*, 280 U. S. 327, 336; *Maryland Casualty Co.* v. *United States*, 251 U. S. 342, 349; *Spring City Co.* v. *Commissioner*, 292 U. S. 182, 189; *White* v. *Winchester Club*, 315 U. S. 32, 41; *United States* v. *Joliet & Chicago R. Co.*, 315 U. S. 44, 47–48; *Textile Mills Corp.* v. *Commissioner*, 314 U. S. 326, 337–339.

CONCLUSION

The decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted.

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JANUARY 1943.

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 13. TAX ON CORPORATIONS IN GENERAL.

(a) *Adjusted Net Income.*—For the purposes of this title the term "adjusted net income" means the net income minus the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation the net income of which is more than $25,000 (except a corporation subject to the tax imposed by section 14, section 231 (a), Supplement G, or Supplement Q) a tax computed under subsection (c) of this section or a tax computed under subsection (d) of this section, whichever tax is the lesser.

(c) *General Rule.*—The tax computed under this subsection shall be as follows:

(1) A tentative tax shall first be computed equal to 19 per centum of the adjusted net income.

(2) The tax shall be the tentative tax reduced by the sum of—

(A) 16½ per centum of the credit for dividends received provided in section 26 (b); and

(B) 2½ per centum of the dividends paid credit provided in section 27, but not to exceed 2½ per centum of the adjusted net income.

* * * * *

SEC. 27. CORPORATION DIVIDENDS PAID CREDIT.

(a) *Definition in General.*—As used in this title with respect to any taxable year the term "dividends paid credit" means the sum of:

(1) The basic surtax credit for such year, computed as provided in subsection (b);

* * * * *

(4) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness. As used in this paragraph the term "indebtedness" means only an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to, and in existence at, the close of business on such date. Where the indebtedness is for a principal sum, with interest, no credit shall be allowed under this paragraph for amounts used or set aside to pay such interest.

(b) *Basic Surtax Credit.*—As used in this title the term "basic surtax credit" means the sum of:

(1) The dividends paid during the taxable year, increased by the consent dividends credit provided in section 28, and reduced by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations;

* * * * *

(e) *Dividends in Obligations of the Corporation.*—If a dividend is paid in obligations of the corporation, the amount with respect thereto which shall be used in computing the basic surtax credit shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. If the fair market value of any such dividend paid in any taxable year of the corporation beginning after December 31, 1935, is lower than the face value, then when the obligation is redeemed by the corporation in a taxable year of the corporation beginning after December 31, 1937, the excess of the amount for which redeemed over the fair market value at the time of the dividend payment (to the extent not allowable as a deduction in computing net income for any taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs.

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 14. SURTAX ON UNDISTRIBUTED PROFITS.

(a) *Definitions.*—As used in this title—

(1) The term "adjusted net income" means the net income minus the sum of—

* * * * *

(2) The term "undistributed net income" means the adjusted net income minus the sum of the dividends paid credit provided in section 27 and the credit provided in section 26 (c), relating to contracts restricting dividends.

(b) *Imposition of Tax.*—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation a surtax equal to the sum of the following, subject to the application of the

specific credit as provided in subsection (c):

7 per centum of the portion of the undistributed net income which is not in excess of 10 per centum of the adjusted net income.

12 per centum of the portion of the undistributed net income which is in excess of 10 per centum and not in excess of 20 per centum of the adjusted net income.

17 per centum of the portion of the undistributed net income which is in excess of 20 per centum and not in excess of 40 per centum of the adjusted net income.

22 per centum of the portion of the undistributed net income which is in excess of 40 per centum and not in excess of 60 per centum of the adjusted net income.

27 per centum of the portion of the undistributed net income which is in excess of 60 per centum of the adjusted net income.

* * * * *

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

* * * * *

(c) Contracts Restricting Payment of Dividends.—

* * * * *

(2) *Disposition of Profits of Taxable Year.*—An amount equal to the portion of the earnings and profits of the taxable year which is required (by a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the disposition of earnings and profits of the taxable year) to be paid within the taxable year in discharge of

a debt, or to be irrevocably set aside within the taxable year for the discharge of a debt; to the extent that such amount has been so paid or set aside. For the purposes of this paragraph, a requirement to pay or set aside an amount equal to a percentage of earnings and profits shall be considered a requirement to pay or set aside such percentage of earnings and profits. As used in this paragraph, the word "debt" does not include a debt incurred after April 30, 1936.

* * * * *

SEC. 27. CORPORATION CREDIT FOR DIVIDENDS PAID.

(a) *Dividends Paid Credit in General.*—For the purposes of this title, the dividends paid credit shall be the amount of dividends paid during the taxable year.

* * * * *

(d) *Dividends in Obligations of the Corporation.*—If a dividend is paid in obligations of the corporation, the amount of the dividends paid credit with respect thereto shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. If the fair market value is lower than the face value, then when the obligation is redeemed by the corporation, the excess of the amount for which redeemed over the fair market value at the time of the dividend payment (to the extent not allowable as a deduction in computing net income for any taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs.

* * * * *

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

ART. 27 (a)–3. *Amounts used or irrevocably set aside to pay or to retire indebtedness.*—(a) *Indebtedness.*—

* * * * * *

Double credits are not permitted, either for the same year or for separate years. Thus, amounts which have been or may be properly taken as a credit pursuant to section 27 (e) of the Act or section 27 (d) of the Revenue Act of 1936 (both sections relating to dividends in obligations of the corporation) may not again be included in the dividends paid credit under section 27 (a) (4) when the obligations are paid. No credit may be allowed under section 27 (a) (4) for amounts used or irrevocably set aside to pay or retire indebtedness which represents an item which is allowable as a deduction from gross income, either for the same year or a different year. Thus the aggregate of the credits allowable under section 27 (a) (4) for amounts used or irrevocably set aside to pay or to retire obligations issued at a discount may not exceed the issue price of such obligations.

* * * * * *

ART. 27 (e)–1. *Dividends in obligations of the corporation.*—Section 27 (e) is concerned solely with the amount of the allowance for dividends paid for purposes of inclusion in the basic surtax credit to the extent that dividends are paid by a corporation in its own obligations. If the corporation ultimately pays a dividend in its own obligations (regardless of the form of the corporate resolution by which the dividend is declared), the amount of the allowance for dividends paid to which it is entitled with respect thereto for the year in which such

dividend is paid is limited to the lesser of the face value or fair market value of such obligations as of the date of payment. If in a taxable year of the corporation beginning after December 31, 1935, the allowance for dividends paid as of the date of payment is limited to the fair market value of the corporate obligations distributed and the corporation redeems such obligations in a taxable year beginning after December 31, 1937, the corporation becomes entitled to an additional allowance for dividends paid in computing the basic surtax credit for the taxable year in which it redeems such obligations, but only in the event that the amount at which such obligations are redeemed is higher than their fair market value at the time of the distribution. The amount of such additional allowance is the excess of the price at which such obligations are redeemed over their fair market value at the time of the distribution, subject to the restriction that such excess be diminished by any amounts which were allowable as deductions for amortized bond discount or bond issue commissions and expenses allocable to the obligations redeemed in computing the net income of the corporation for any taxable year. A corporation is entitled to such additional allowance regardless of the identity of the holders of the obligations at the time of their redemption.

* * * * *

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 518

GUY T. HELVERING,
COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SABINE TRANSPORTATION COMPANY, INC.,
Respondent

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 518

GUY T. HELVERING,
COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SABINE TRANSPORTATION COMPANY, INC.,
Respondent

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit

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BRIEF FOR RESPONDENT IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

Introduction

On November 9, 1942, a petition was filed on behalf of Guy T. Helvering, Commissioner of Internal Revenue, praying that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Fifth Circuit entered in the above entitled cause on June 30, 1942.

Opinion Below

The memorandum opinion of the Board of Tax Appeals (R. 19-22) is unreported. The opinion of the Circuit Court of Appeals is reported at 128 Federal (2d) 845, and the text will be found in the Appendix at page 18.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered on June 30, 1942. A petition for rehearing was filed by the Commissioner of Internal Revenue on July 18, 1942, and such petition was denied August 13, 1942. The jurisdiction of this Court has been invoked under Section 240(a) of the JUDICIAL CODE as amended by the Act of February 13, 1925.

Notice of the filing of the petition herein, together with notice that no brief will be filed, copies of petition and transcript of record were served on counsel for respondent on November 16, 1942.

Question Presented

Where a taxpayer declared and paid a dividend in its own notes during the year 1937 and was allowed a dividends paid credit in 1937 for the dividend so declared and paid, is not the taxpayer upon payment of such notes in 1938, by the plain mandate of Section 27(a)(4) of the 1938 Act, entitled to include in its dividends paid credit for 1938 such payments as "amounts used * * * to pay or retire indebtedness of any kind * * *"?

Statutes and Regulations Involved

The statutes and regulations involved will be found in the Appendix, infra, pages 15-17.

Statement

The facts as stipulated (R. 10-19) were adopted by the Board of Tax Appeals as its findings (R. 19). The facts relevant to this proceeding are summarized as follows:

During the year 1937 taxpayer, acting under proper authority of its Board of Directors, declared and paid a dividend amounting to $530,000.00 in its own notes. For undistributed profits tax purposes, in its return for the year 1937 taxpayer claimed and was allowed a dividends paid credit, by reason of such dividend paid, amounting to $530,000.00 (R. 19-21). In 1938 taxpayer paid its note indebtedness in the amount of $530,000.00 which was issued by it in 1937 in payment of the dividend. In its return for the year 1938 taxpayer claimed a dividends paid credit under Section 27(a)(4) of the REVENUE ACT of 1938 for the notes so paid by it in 1938. The Commissioner disallowed the credit claimed for 1938 and was sustained by the Board of Tax Appeals (R. 21-22). The taxpayer appealed and the Circuit Court of Appeals for the Fifth Circuit reversed (R. 36).

Summary of Argument

I.

What appears to be a conflict between decisions of the Ninth and Fifth Circuits has been resolved.

II.

The question here presented for all practical purposes is now moot.

III.

The decision below is correct.

IV.

The inclusion of the $530,000.00 in Respondent's dividends paid credit does not result in a second credit of the same character, but if it does Congress intended it that way.

Argument

I.

What appears to be a conflict between decisions of the Ninth and Fifth Circuits has been resolved.

The Petitioner herein asks this Court to grant his application for writ of error on the grounds that the decision of the Court below in this case is in conflict with the decision of the Circuit Court of Appeals for the Ninth Circuit in SPOKANE DRY GOODS COMPANY v. COMMISSIONER, reported at 125 Fed. (2d) 865. The decision in the SPOKANE DRY GOODS COMPANY case held that the terms of Subsection (e) of Section 27 of the REVENUE ACT of 1938 controls over the terms of Subsection (a) (4) of Section 27, while the Court below in its decision of the case at bar held that it does not.

The Ninth Circuit decided the SPOKANE DRY GOODS COMPANY case on February 18, 1942. There was pending in this Court on that date HELVERING v. CREDIT ALLIANCE CORPORATION (No. 775, October Term, 1941). Credit Alliance Corporation had liquidated by distributing its assets in kind to its parent corporation, and the question was whether it was entitled to a dividends paid credit for the distribution under Section 27(f) of the REVENUE ACT of 1936. The Commissioner contended that since the liquidating dividend was not taxable to the parent corporation (Section 112(b)(6)), the credit was barred by the provisions of Section 27(h). A comparison of Subsections 27(f) and (h) of the 1936 Act and Subsections (a) (4) and (e) of the REVENUE

ACT of 1938, together with the applicable Regulations, is set forth below:

SUBSECTIONS (f) AND (h), 1936 ACT:

"(f) Distributions in Liquidation.—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid."

SUBSECTIONS (a) (4) AND (e), 1938 ACT:

"(a) Definition in General.—As used in this title with respect to any taxable year the term 'dividends paid credit' means the sum of:

"(4) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness. As used in this paragraph the term 'indebtedness' means only an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to and in existence at, the close of business on such date. Where the indebtedness is for a principal sum, with interest, no credit shall be allowed under this paragraph for amounts used or set aside to pay such interest."

"(h) Nontaxable Distributions.—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part."

ARTICLE 27 (f), REGULATION 94:

* * *

"On the other hand, certain transactions described in Sections 112 and 115 are treated, for the purposes of the Act, not as distributions

"(e) Dividends in Obligations of the Corporation.—If a dividend is paid in obligations of the corporation, the amount with respect thereto which shall be used in computing the basic surtax credit shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. If the fair market value of any such dividend paid in any taxable year of the corporation beginning after December 31, 1935, is lower than the face value, then when the obligation is redeemed by the corporation in a taxable year of the corporation beginning after December 31, 1937, the excess of the amount for which redeemed over the fair market value at the time of the dividend payment (to the extent not allowable as a deduction in computing net income for any taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs."

ARTICLE 27 (a)-3, REGULATION 101:

* * *

"Double credits are not permitted, either for the same year or for separate years. Thus, amounts which have been or may be properly

to the shareholders of earnings or profits, but as transfers of such earnings or profits intact to another corporation in whose hands such earnings or profits, being available for distribution by it as dividends to its shareholders, have essentially the same status for the purposes of the Act as earnings or profits derived from its own operations. Characteristic of these transactions is the circumstance that the gain or loss realized from the receipt by the shareholders of property is not recognized by the Act. No dividends paid credit is allowable with respect to such transactions."

taken as a credit pursuant to Section 27 (e) of the Act or Section 27 (d) of the Revenue Act of 1936 (both sections relating to dividends in obligations of the corporation) may not again be included in the dividends paid credit under Section 27 (a) (4) when the obligations are paid. No credit may be allowed under Section 27 (a) (4) for amounts used or irrevocably set aside to pay or retire indebtedness which represents an item which is allowable as a deduction from gross income, either for the same year or a different year. Thus the aggregate of the credits allowable under Section 27 (a) (4) for amounts used or irrevocably set aside to pay or to retire obligations issued at a discount may not exceed the issue price of such obligations."

MR. JUSTICE ROBERTS, speaking for the Court in the CREDIT ALLIANCE CORPORATION case, said that it was not at liberty to disregard the direct and unambiguous language of Subsection (f); that the Regulation was not only contradictory to the plain terms of the subsection, but tends to add a supplementary legislative provision which could only have been enacted by Congress; and that the Court below was right in refusing to give effect to the Regulation.

The same thing is true here. The language of Section 27 (a) (4) is plain and unambiguous. It requires the inclusion in the dividends paid credit of *amounts used or irrevocably*

set aside to pay or retire indebtedness of any kind. The Regulation which the petitioner seeks to invoke contravenes the plain mandate of the statute and it too is, therefore, legislative in character rather than interpretative.

The Court below thought that there was a direct parallel between the situation involved in the present case and the CREDIT ALLIANCE CORPORATION case. After pointing out that the construction of a statute to make it carry out the intent its words import is one thing and that a construction which brings it nearer to what the administrator or court thinks Congress intended or ought to have intended is quite another, the Court said:

> "However, we need not further labor the point here, for in Helvering v. Credit Alliance Association, April 27, 1942, — U.S. —, the Supreme Court, rejecting the same kind of reasoning as to a dividends paid credit claimed under Section 27(b) of the Revenue Act of 1936 and declaring invalid a regulation which contravened the plain terms of the statute, has set the matter at rest."

Since the decision by the Ninth Circuit in the SPOKANE DRY GOODS COMPANY case was entered before this Court decided the CREDIT ALLIANCE CORPORATION case and since the reasoning and the statutory construction applied in the SPOKANE DRY GOODS COMPANY case appear to be contrary to the reasoning and rules of statutory construction applied by this Court in its CREDIT ALLIANCE CORPORATION case decision, the decision of the Ninth Circuit in the SPOKANE DRY GOODS COMPANY case has been in effect overruled by this Court and therefore no conflict now exists between the Circuit Courts on the question raised in the petition for writ of certiorari.

II.

The question here presented for all practical purposes is now moot.

Petitioner herein properly states that the issue which is the subject of his application can not arise in the future. The issue can arise only with respect to corporations with taxable years beginning between January 1, 1938, and December 1, 1939, by reason of the fact that the REVENUE ACT of 1940 and subsequent Acts do not contain sections providing a dividends paid credit for the ordinary corporate taxpayer. The probability of the question arising even in 1939 is further reduced by the fact that the issue here involved can arise only with respect to dividend obligations that were outstanding on December 31, 1937. There are only a few cases pending in which the question is involved. (Page 5 of Petition.) Thus it is apparent that petitioner is asking this Court to expend its labors to decide a question that is of but little importance or public concern and one that is for all practical purposes now moot. If this Court should undertake to pass on the question presented by the petition, all that it would decide would be whether or not the taxpayers in the comparatively few pending cases owe the tax.

III.

The decision below is correct.

The petitioner herein urges that the terms of Subsection (e) of Section 27 of the Revenue Act of 1938 limit or control over the terms of Subsection (a) (4) of Section 27. The court below held otherwise.

Subsection (a) of Section 27 enumerates the items, the sum

of which constitutes the dividends paid credit. They are in so far as this issue is concerned:

> "(1) The basic surtax credit * * * (which, in so far as it applies to the question with which we are here concerned, means dividends paid during the taxable year).
>
> * * *
>
> "(4) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind * * * ." (Material in parentheses supplied.)

These provisions of Section 27 are not alternates, but are cumulative. That is, they are component parts of a whole, the sum of which goes to make up the dividends paid credit.

Subsection (e) of Section 27 contains two sentences. The first sentence specifies the extent to which a dividend paid in obligations of a corporation on or after January 1, 1938, the effective date of Section 27 of the 1938 Act, shall be treated as a dividend paid and, therefore, the extent to which such a dividend is includible under Subsection (a) (1) of Section 27. We are not here concerned with the provisions of this sentence, because respondent paid no dividend on or after January 1, 1938, in its notes. The second sentence provides that if a corporation paid a dividend in a taxable year beginning between December 31, 1935, and January 1, 1938, in its obligations which had a fair market value at the date of issue of less than the amount for which they were ultimately redeemed in a taxable year beginning on or after January 1, 1938, then such excess (the amount paid in redemption of the obligations over their fair market value on the date issued) "shall be treated as a dividend paid in the taxable year in which the redemption occurs." The function of said sentence was to classify the excess as a dividend and thus make it includible as "dividends paid" under Subsection (a) (1) of Section 27, and there is no

relation between it and the provisions of Subsection (a) (4) of Section 27.

Subsection (e) of Section 27, therefore, treats only of the extent to which certain amounts are to be included in the dividends paid credit as dividends paid, and dividends paid are includible in the dividends paid credit only under Subsection (a) (1) of Section 27. Subsection (a) (4) of Section 27 treats of what is includible in the dividends paid credit for the payment of indebtedness, and that is "indebtedness of any kind." The terms of Subsection (e) of Section 27, therefore, do not operate to limit or control over the terms of Subsection (a) (4) of Section 27, but operate only to broaden what was includible in the dividends paid credit under Subsection (a) (1) of Section 27. Obviously, therefore, the decision below holding that the terms of Subsection (e) do not control over or limit the terms of Subsection (a) (4) is correct.

IV.

The inclusion of the $530,000.00 in Respondent's dividends paid credit does not result in a second credit of the same character, but if it does Congress intended it that way.

The petitioner points out that the court below allowed a second credit in 1938 on account of an obligation which had already been the subject of a full credit for the previous year at the time of its issuance and that this extraordinary result alone might have suggested the view of Congressional intent adopted in the Regulation.

It is true that respondent received a credit when the notes were issued in payment of the dividend and under the decision of the court below also receives a credit on account of the payment of the obligation in 1938. However, said credits were

not against the same thing. The credit received when the obligations were issued was against income. The credit received in 1938 when the obligations were paid was against tax. The earlier credit was for dividends paid. The later credit was for debts paid. The credits provided for were with respect to separate and distinct schemes of taxation. The credit under the 1936 Act could be sufficient to eliminate the undistributed profits tax entirely. The purpose of the credit was to encourage the distribution of dividends and thus increase the amount of tax that would be paid by corporate stockholders. The undistributed profits tax was eliminated by the Revenue Act of 1938 and a flat rate of tax on the income of corporations was imposed. Congress, however, not only retained the dividends paid credit provisions of the 1936 Act in the 1938 Act, but broadened their scope. It evidently thought it wise to continue to encourage corporations to distribute their earnings in the form of dividends.

The credit, however, under the 1938 Act, was not against income as was the credit under the 1936 Act, but it was a direct credit against tax. The credit was 2½% of the dividends paid credit provided in Section 27. The debt credit provision, Section 27 (a) (4), was new in the 1938 Act. The purpose of this provision was to give relief to corporations by way of a dividends paid credit for amounts paid in retirement of indebtedness and thus made unavailable for the payment of dividends. Bearing this purpose in mind, it would make no difference how the indebtedness arose. This accounts for the words "any kind" used after the word "indebtedness" in Section 27 (a) (4). It would seem that in view of this broad language it was the intention of Congress that there should be included in the dividends paid credit amounts paid on indebtedness irrespective of how the indebtedness arose or whether the taxpayer received any tax benefit from it when created.

Such view is borne out by the decision of the Board of Tax

Appeals in the case of PACIFIC FLUSH TANK COMPANY v. COMMISSIONER, 45 B.T.A. 869. The facts in that case were that the taxpayer paid a bonus in 1937 in 4% notes and claimed the amount thereof as a business expense deduction in its 1937 return and the deduction was allowed. The notes were paid in full in 1938 and the payment was included in computing the taxpayer's dividends paid credit under Section 27 (a) (4).

The Board held that the language of Section 27 (a) (4) was unambiguous, required no interpretation and that even though the taxpayer had obtained the benefit of the deduction in its 1937 return there was no legal justification for denying the debt paid credit when the notes were paid. This decision, in effect, overrules the Board's decision in the present case. Although the Commissioner filed a petition for review of the decision in the PACIFIC FLUSH TANK COMPANY case the proceeding was later docketed and dismissed. (PRENTICE-HALL 1942 par. 61085.) Consequently, it must be assumed that the Commissioner now agrees with the decision in the PACIFIC FLUSH TANK COMPANY case.

Had respondent in 1937 given notes amounting to $530,000.00 to its creditors for materials, etc., and used the cash funds to pay the $530,000.00 dividend in cash and in 1938 paid the notes amounting to $530,000.00, no question with respect to a double credit could have been raised. Yet respondent would have been in exactly the same financial condition and would have received exactly the same dividends paid credit that has been allowed by the court, i.e., a credit in 1937 for the payment of a dividend and a credit in 1938 for the payment of indebtedness. Since the credit in 1937 is for the payment of a dividend and the credit in 1938 is expressly allowed by Section 27 (a) (4) for the payment of indebtedness, the credits are of an entirely different character and for a different purpose and in reality the double credit or deduction question, as known to tax law, is not present.

Conclusion

It is respectfully submitted that the petition should be denied.

Chas I Francis

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Attorney for Respondent,
SABINE TRANSPORTATION
COMPANY, INC.

Appendix

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 13. TAX ON CORPORATIONS IN GENERAL.

(a) ADJUSTED NET INCOME.—For the purposes of this title the term "adjusted net income" means the net income minus the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations.

(b) IMPOSITION OF TAX.—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation the net income of which is more than $25,000 (except a corporation subject to the tax imposed by section 14, section 231 (a), Supplement G, or Supplement Q) a tax computed under subsection (c) of this section or a tax computed under subsection (d) of this section, whichever tax is the lesser.

(c) GENERAL RULE.—The tax computed under this subsection shall be as follows:

(1) A tentative tax shall first be computed equal to 19 per centum of the adjusted net income.

(2) The tax shall be the tentative tax reduced by the sum of—

(A) 16½ per centum of the credit for dividends received provided in section 26 (b); and

(B) 2½ per centum of the dividends paid credit provided in section 27, but not to exceed 2½ per centum of the adjusted net income.

* * *

SEC. 27. CORPORATION DIVIDENDS PAID CREDIT.

(a) DEFINITION IN GENERAL.—As used in this title with respect to any taxable year the term "dividends paid credit" means the sum of:

(1) The basic surtax credit for such year, computed as provided in subsection (b);

* * *

(4) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness. As used in this paragraph the term "indebtedness" means only an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to, and in existence at, the close of business on such date. Where the indebtedness is for a principal sum, with interest, no credit shall be allowed under this paragraph for amounts used or set aside to pay such interest.

(b) BASIC SURTAX CREDIT.—As used in this title the term "basic surtax credit" means the sum of:

(1) The dividends paid during the taxable year, increased by the consent dividends credit provided in section 28, and reduced by the amount of the credit provided in section 26 (a), relating to interest on certain obligations of the United States and Government corporations;

* * *

(e) DIVIDENDS IN OBLIGATIONS OF THE CORPORATION.—If a dividend is paid in obligations of the corporation, the amount with respect thereto which shall be used in computing the basic surtax credit shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. If the fair market value of any such dividend paid in any taxable year of the corporation beginning after December 31, 1935, is lower than the face value, then when the obligation is redeemed by the corporation in a taxable year of the corporation beginning after December 31, 1937, the excess of the amount for which redeemed over the fair market value at the time of the dividend payment (to the extent not allowable as a deduction in computing net income for any

taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

ART. 27 (a)-3. Amounts used or irrevocably set aside to pay or to retire indebtedness.—(a) Indebtedness.—

* * *

Double credits are not permitted, either for the same year or for separate years. Thus, amounts which have been or may be properly taken as a credit pursuant to Section 27(e) of the Act or Section 27(d) of the Revenue Act of 1936 (both sections relating to dividends in obligations of the corporation) may not again be included in the dividends paid credit under Section 27(a)(4) when the obligations are paid. No credit may be allowed under Section 27(a)(4) for amounts used or irrevocably set aside to pay or retire indebtedness which represents an item which is allowable as a deduction from gross income, either for the same year or a different year. Thus the aggregate of the credits allowable under Section 27(a)(4) for amounts used or irrevocably set aside to pay or to retire obligations issued at a discount may not exceed the issue price of such obligations.

Opinion of the Court

Filed June 30, 1942

In the United States Circuit Court of Appeals for the Fifth Circuit

No. 10077

SABINE TRANSPORTATION COMPANY, INC., *Petitioner*
versus
COMMISSIONER OF INTERNAL REVENUE, *Respondent*

Petition for Review of Decision of the United States Board of Tax Appeals (District of Texas)

June 30, 1942

Before SIBLEY, HUTCHESON, and HOLMES, Circuit Judges

HUTCHESON, Circuit Judge: Submitted upon stipulation as to the facts,[1] the Board, following its decision in Spokane

[1] In 1937, taxpayer, a Delaware Corporation having two stockholders, Pure Oil Corporation and Sabine Towing Company, Inc., declared and paid on its outstanding common stock, cash dividends of $30,000, and a further dividend of $530,000 by the issuance and delivery of its 10 year 8% notes. In its federal income and excess profits tax return for 1937 the petitioner reported the cash dividends and the dividends paid in its obligations, and they were allowed as dividends paid credits.* During the tax year, 1938, the year involved in this proceeding, the 10 year dividend notes were paid to its stockholders in cash and in its return for 1938, taxpayer reported these distributions to stockholders and claimed a dividends paid credit, under Sec. 27(a)(4), Revenue Act of 1938, on account of the sums used to pay and retire them. Respondent disallowed the claim and taxpayer brought the matter to the Board.

*Section 27 of Revenue Act of 1936:

Dry Goods Co. v. Commissioner,[2] sustained the determination of the Commissioner that in computing its income tax for the taxable year 1938, the taxpayer was not entitled under 27(a)(4),[3] to take a dividends paid credit for the $530,000 used to pay or retire the notes issued in 1937 as dividends paid on its obligation.

Taxpayer is here insisting, that by the plain mandate of the section it is entitled to the credit claimed and that both this and the Spokane case were wrongly decided. The Commissioner, standing on the Spokane Case and on the regulation that case approved, insists that the order of the Board was

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Sec. 27. Corporation Credit for Dividends Paid.

(a) Dividends Paid Credit in General.—For the purposes of this title, the dividends paid credit shall be the amount of dividends paid during the taxable year. * * *

(d) Dividends in Obligations of the Corporation.—If a dividend is paid in obligations of the corporation, the amount of the dividends paid credit with respect thereto shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. * * *

[2] 43 B. T. A. 793, Affd., 125 F. (2d) 865.

[3] Sec. 27. Corporation Dividends Paid Credit:

"(a) Definition in General. As used in this title with respect to any taxable year the term 'dividends paid credit' means the sum of: (1) * * * (2) * * * (3) * * * and (4) 'Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness.' As used in this paragraph the term 'Indebtedness' means only an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to and in existence at the close of business on such date. Where the indebtedness is for a principal sum, with interest no credit shall be allowed under this paragraph for amounts used or set aside to pay such interest."

right and must be affirmed. We do not think so. We think it clear; that the Spokane Case was wrongly decided by Board and court; that the dissenting opinion of Board member Hill, clearly and correctly stated the law of that case; and that in the Pacific Flush Tank Case,[4] the Board while in terms differentiating, in effect overruled its prior decision. We agree with what it there said. "The terms of the statute as applicable to the facts of this case, are so plain and unambiguous as to require in our opinion no resort to construction in order to ascertain its meaning. However, if it could be said that the application of the literal meaning of the statute leads to results which should be avoided, that is, the granting of a double tax benefit, and that this statute should be construed in the light of the purpose and intent of Congress in enacting same, we nevertheless * * * conclude that even if the allowance of the credit claimed here would result in duplicating in whole or in part a tax benefit to the petitioner, it nevertheless appears clear that Congress intended to and did expressly grant such credit. And we further conclude that Art. 27(a)(3) of Regulations 101, purporting to deny such credit is contrary to the statute and is therefore a nullity as applied to the facts of this case."

We think it clear that in attempting, by speculating as to what Congress intended to do except as that intent was expressed in the statute, to rationalize out of the section the comprehensive words which specifically grant the deduction, the Commissioner is attempting to have us arrogate to ourselves the function of rewording rather than of construing and applying the statute.[5] The construction of a statute to make it carry out the intent its words import is one thing. The construction of it to bring it nearer to the thought of administrator or court, or of some particular section of public opinion, as to what Congress intended or ought to have in-

[4] Pacific Flush Tank Co. v. Commissioner, 45 B. T. A. 69.

[5] "Courts and Administrative agencies are bound to enforce the plain words of the statute although there may be reason to think in view of the general legislative purpose that some other provision would have met with favor, if the legislature had called it to mind." Commissioner of Internal Revenue v. Windrow, 89 F. (2d) 69, 110 A.L.R. 1251.

tended, or that the law would better serve its purpose if it were drawn that way,[6] is quite another. However, we need not further labor the point here, for in *Helvering v. Credit Allowance Association*, April 27, 1942, — U.S. —, the Supreme Court, rejecting the same kind of reasoning as to a dividends paid credit claimed under Section 27(b) of the Revenue Act of 1936, and declaring invalid a regulation which contravened the plain terms of the statute, has set the matter at rest. Definitely reaffirming the principle that it is for the courts not to write but to enforce a statute, the court said: "But we cannot, as the Government suggests, read into the section, as it stood when the transaction took place, an intent derived from the policy disclosed by the subsequent amendment. We shall not burden this opinion by extended reference to the legislative history of the Act of 1936. It is enough to say that it is inconclusive and, to some extent, supports the arguments of both parties. But what-

[6] "A legislative act in the United States is not as in some countries, a mere general outline by a party or group in power, of the purposes it wishes to accomplish, to be expanded, implemented and given effect by its administrators in accordance with the general purposes of its proponents. A fundamental fact in American political life has always been that in the struggle here for laws as means, to make law as liberator effective, there have always been differing opinions, as to the wisdom, propriety and scope of proposed new and controversial laws. Laws as finally enacted here, are usually the result of a compromise, or at least of an adjustment of these conflicting views.

"Because this is and always has been so, it can be usually said of our laws, that the general, not the partial or partisan will, speaks in them. It is because this is so, that canons of statutory interpretation and construction require that statutes must be construed and given effect, in accordance with the language chosen for the expression, of this compromise and adjustment of views, and not in accordance with the purposes or views, of either the proponents or the opponents of the legislation, which have not been given expression in the statute." Fleming v. Belo, 121 F. (2d) at 212-13, Aff'd. June 9, 1942, — U.S. —.

ever may be said of the policy behind the statute's provisions, we are not at liberty to disregard the direct and unambiguous language of Subsection (f)." The principle there announced has controlling force here. Congress, for reasons of its own, in working out a compromise or adjustment, of the very controversial questions raised by the policy of, in effect, taxing corporations on dividends unpaid and of allowing them credits on those paid or what was regarded as the equivalent, drew the dividends paid statutes in the terms in which we find them. The taxpayer, conforming to the statute, paid dividends in its obligations in 1937. Still conforming to the statute it paid these obligations in 1938 and claimed the dividends credit the statute allowed, for the payment or retirement of "indebtedness of any kind." It is not for the commissioner or the courts to deny the taxpayer the deduction that Congress has granted him. The order is reversed and the cause is remanded for further and not inconsistent proceedings.

Reversed and remanded.

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CHARLES ELMORE CROPLEY
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1942

No. 518

GUY T. HELVERING,
COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

v.

SABINE TRANSPORTATION COMPANY, INC.,
Respondent

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit

BRIEF FOR RESPONDENT

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BRIEF FOR RESPONDENT

Opinion Below

The memorandum opinion of the Board of Tax Appeals (R. 19-22) is unreported. The opinion of the Circuit Court of Appeals is reported at 128 Federal (2d) 845, and the text will be found in the Appendix at page 17.

Jurisdiction

The judgment of the Circuit Court of Appeals was entered on June 30, 1942. A petition for rehearing was filed by the Commissioner of Internal Revenue on July 18, 1942, and such petition was denied August 13, 1942. The jurisdiction of this Court has been invoked under Section 240(a) of the JUDICIAL CODE as amended by the Act of February 13, 1925.

Question Presented

Where a taxpayer declared and paid a dividend in its own notes during the year 1937 and was allowed a "dividends paid credit" in 1937 for the dividend so declared and paid, is not the taxpayer upon payment of such notes in 1938, by the plain mandate of Section 27(a)(4) of the 1938 Act, entitled to include in its "dividends paid credit" for 1938 such payments as "amounts used * * * to pay or retire indebtedness of any kind * * * ?"

Statutes and Regulations Involved

The statutes and regulations involved will be found in the argument and Appendix, infra, pages 25-30.

Statement

The facts as stipulated (R. 10-19) were adopted by the Board of Tax Appeals as its findings (R. 19). The facts relevant to this proceeding are summarized as follows:

During the year 1937 respondent, acting under proper authority of its Board of Directors, declared and paid a dividend amounting to $530,000.00 in its own notes. For undistributed profits tax purposes, in its return for the year 1937, respondent claimed and was allowed a "dividends paid credit," by reason of such dividend paid, amounting to $530,000.00 (R. 19-21). In 1938 taxpayer paid its note indebtedness in the

amount of $530,000.00 which was issued by it in 1937 in payment of the dividend. In its return for the year 1938 respondent claimed a "dividends paid credit" under Section 27 (a) (4) of the REVENUE ACT OF 1938 for the notes so paid by it in 1938. The Commissioner disallowed the credit claimed for 1938 and was sustained by the Board of Tax Appeals (R. 21-22). The respondent appealed and the Circuit Court of Appeals for the Fifth Circuit reversed (R. 36).

Summary of Argument

The Revenue Act of 1938 levied a tentative tax of 19 per cent on corporate net income against which was allowed a credit equal to 2½ per cent of the "dividends paid credit" defined by Section 27.

"Dividends paid credit" is a technical term, specifically and definitely defined. One of its components is "amounts used or irrevocably set aside to pay or to retire indebtedness of any kind" (Subsection (a) (4)). The term "indebtedness" is also specifically and definitely defined in the statute.

Respondent in 1938 paid $530,000.00 to retire certain notes which respondent issued in 1937 to its stockholders in payment of a dividend declared in 1937. Respondent claims that the payment made to retire the notes must be included in computing its "dividends paid credit" for 1938 under Section 27 because the $530,000.00 was an amount used to pay indebtedness *of any kind.*

The Commissioner contends that the statute should be so construed as to exclude payments of indebtedness from the "dividends paid credit" where a credit was received for the indebtedness in the year the indebtedness was created.

Section 27 (a) (4), on which respondent relies, defines the word "indebtedness" in definite and specific terms. The statutory definition can not lawfully be restricted or limited by administrative regulation.

The language of Section 27.(a) (4) is clear and unambiguous. Anyone can understand it. There is, therefore, no occasion to resort to rules of construction to aid in determining the meaning of the statute.

Subsection (e) of Section 27 does not limit or control over Subsection (a) (4) of said section. These two subsections are entirely unrelated to, and independent of, each other.

Subsection (a) (4) contains its own limitations. No other limitation or limitations may be impinged upon it by administrative regulation. When Congress enacted Subsection (a) (4) it knew that many dividend obligations were outstanding. Had it meant for payments made in retirement of such obligations to be excluded from the debt credit provision of (a) (4) it would have said so.

The legislative history of Subsection (a) (4) shows that it was intended to apply to indebtedness of every kind and character. The words "of any kind" were inserted after "indebtedness" in the original language for clarification after there had been a controversy over the meaning of "indebtedness."

This Court in HELVERING v. CREDIT ALLIANCE CORPORATION, infra, rejected the same reasoning that the Commissioner would have applied here. The Court held that a departmental regulation which contravened the plain language of a statute was legislative in character and hence void. The Regulation which the Commissioner relies on here contravenes the plain terms of Subsection (a) (4) and it is likewise legislative in character and without force or effect.

Argument

This case arises under the Revenue Act of 1938 but has relation to the Revenue Act of 1936. The Revenue Act of 1936 for the first time imposed a surtax on the undistributed profits of corporations. The tax ranged from 7 to 27 per cent

of the "undistributed net income." A "dividends paid credit" was allowed against the "adjusted net income." Provision was made for the payment of dividends in corporate obligations. The objective of the tax was to force corporations to distribute their earnings to the end that their stockholders would pay an income tax on the distributions. If a corporation distributed all of its "adjusted net income" it avoided entirely the tax on "undistributed profits."

The undistributed profits tax met with much opposition and it was not continued in the Revenue Act of 1938. By the latter Act a tentative tax of 19 per cent was imposed and provision was made for a credit against the *tax* equal to 2½ per cent of the "dividends paid credit" but not in excess of 2½ per cent of the "adjusted net income." The "dividends paid credit" was broadened and continued in the 1938 Act because Congress evidently considered it advisable to continue to encourage corporations to distribute their earnings.

The provisions of the 1938 Act pertinent to this case are:

SEC. 13. TAX ON CORPORATIONS IN GENERAL.

(c) General Rule.—The tax computed under this subsection shall be as follows:

(1) A tentative tax shall first be computed equal to 19 per centum of the adjusted net income.

(2) The tax shall be the tentative tax reduced by the sum of—

(A) 16½ per centum of the credit for dividends received provided in Section 26(b); and

(B) 2½ per centum of the dividends paid credit provided in Section 27, but not to exceed 2½ per centum of the adjusted net income.

SEC. 27. CORPORATION DIVIDENDS PAID CREDIT.

(a) Definition in General.—As used in this title with respect to any taxable year the term "dividends paid credit" means the sum of:

(1) The basic surtax credit for such year, computed as provided in Subsection (b);

(2) The dividend carry-over to such year, computed as provided in Subsection (c);

(3) The amount, if any, by which any deficit in the accumulated earnings and profits, as of the close of the preceding taxable year (whether beginning on, before, or after January 1, 1938), exceeds the amount of the credit provided in Section 26(c) (relating to net operating losses), for such preceding taxable year (if beginning after December 31, 1937); and

(4) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness. As used in this paragraph the term "indebtedness" means only an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to, and in existence at, the close of business on such date. Where the indebtedness is for a principal sum, with interest, no credit shall be allowed under this paragraph for amounts used or set aside to pay such interest.

(b) Basic Surtax Credit.—As used in this title the term "basic surtax credit" means the sum of:

(1) The dividends paid during the taxable year, increased by the consent dividends credit provided in Section 28, and reduced by the amount of the credit provided in Section 26(a), relating to interest on certain obligations of the United States and Government corporations;

* * *

(e) Dividends in Obligations of the Corporation.—If a dividend is paid in obligations of the corporation, the amount with respect thereto which shall be used in computing the basic surtax credit shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. If the fair market value of any such dividend paid in any taxable year of the corporation beginning after December 31, 1935, is lower than the face value, then when the obligation is redeemed by the corporation in a taxable year of the corporation beginning after December 31, 1937, the excess of the amount for which redeemed over the fair market value at the time of the dividend payment (to the extent not allowable as a deduction in computing net income for any taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs.

It will be noted that "dividends paid credit" is a technical term and does not necessarily have any relation to dividends. The term includes in addition to dividends paid in cash or obligations, amounts set aside or paid to retire indebtedness of any kind, net operating losses carried over from the previous year, certain deficits in accumulated earnings and other items not related to dividends at all, and must be distinguished from the much narrower term "basic surtax credit."

The respondent in the year 1937 paid a dividend of $530,000.00 in its own notes and respondent's stockholders reported such dividend in their respective income tax returns and paid the required tax thereon. This accomplished the objective of the surtax on undistributed profits imposed by the Revenue Act of 1936. Respondent claimed in its 1937 return and the Commissioner allowed a "dividends paid credit" equal to the face amount of the notes in computing respondent's liability for the undistributed profits tax imposed by the Revenue Act of 1936. Respondent paid the aforesaid notes in full in 1938 and included the $530,000.00 payment in its

"dividends paid credit" for the year 1938 under authority of Subsection (a) (4) of Section 27 of the REVENUE ACT OF 1938. The credit thus claimed for the year 1938 was disallowed by the Commissioner under the purported authority of Article 27 (a)-3 of TREASURY REGULATION 101. (App. page 30). The Board of Tax Appeals upheld the Regulation on authority of its previous decision in the case of SPOKANE DRY GOODS COMPANY v. COMMISSIONER, 43 B.T.A. 793, which was subsequently affirmed by the Circuit Court of Appeals for the Ninth Circuit, 125 Fed. (2d) 865. The Circuit Court of Appeals for the Fifth Circuit reversed the Board in respondent's case and approved respondent's contention that Subsection (a) (4) is so plain and unambiguous as not to permit or require resort to the aid of rules of construction to interpret it. The Fifth Circuit Court thought that any question as to the correctness of respondent's contention was put at rest by the decision of the Supreme Court of the United States in HELVERING v. CREDIT ALLIANCE CORPORATION, 316 U.S. 107, 62 S. Ct. 989. The SPOKANE DRY GOODS COMPANY case was decided by the Ninth Circuit prior to the time this Court decided HELVERING v. CREDIT ALLIANCE CORPORATION.

The Commissioner makes much the same contention here as he did in HELVERING v. CREDIT ALLIANCE CORPORATION, supra. In that case he argued that Subsection (h) of Section 27 of the REVENUE ACT OF 1936 should be read as an exception to, or limitation on, Subsection (f) (App. page 29). In this case the Commissioner contends that Subsection (e) of Section 27 should be read as an exception to, or limitation on, Subsection (a) (4) and argues that the Treasury Regulation on which he relies is supported by four canons of statutory construction, namely that specific provisions of a statute control over general provisions, a harmonious statutory scheme should be sought and absurd results avoided,

double deductions are not permissible,[1] and credit provisions should be strictly construed.

We reply to the contentions of the Commissioner that Congress itself in Subsection (a) (4) defined the term "indebtedness" as meaning "an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage or deed of trust, issued by the corporation and in existence on December 31, 1937, or by a bill of exchange accepted by the corporation prior to and in existence on such date" and that, therefore, the Treasury Department is not at liberty to add to or restrict the meaning of the term "indebtedness" as it has attempted to do by declaring in REGULATIONS 101, Article 27 (a)-3, that amounts which have been taken as a credit pursuant to Subsection (e) may not again be included in the dividends paid credit under Subsection (a) (4) when the obligations are paid. Said provision is an attempt to engraft a restriction on the clear meaning of

[1] The Commissioner argues that the allowance of a credit when the notes were issued in 1936 and again when they were paid in 1938 results in a duplicate or double credit. As pointed out in the dissenting opinion of Member Hill (App. p. 21) in **Spokane Dry Goods Company**, 43 B.T.A. 793, this is not so. The credits under the two Acts are applied differently and under radically different plans of taxation. Under the 1936 Act the taxpayer's credit was against income to the full extent but for surtax purposes only; in 1938 it was a credit against normal tax to the extent of 2½ per cent only (limited by a maximum of 2½ per cent of the income); in 1937 the credit was for dividends paid; in 1938 it was for indebtedness paid. How then can it be said that such credits are duplicates? If there is a duplication, how can the extent thereof be calculated?

But even if such Section 27(a)(4) results in allowing a duplicate credit, Congress granted it and there is no absolute prohibition against the allowance of a double deduction. Where Congress grants a double deduction the Courts are bound to sustain it. (See **Robert J. Kleberg**, 31 B.T.A. 95, and **Adams v. Commissioner**, 110 Fed. (2d) 578, where it was held that deductions for the same expense may be taken both in determining income tax and the net estate subject to tax, and also **Pacific Flush Tank Company v. Commissioner**, 45 B.T.A. 869, where after having been allowed a business expense deduction for a bonus paid in notes the taxpayer was held entitled to include the payment of the notes in his "dividends paid credit" as a payment on indebtedness.)

the term "indebtedness" as Congress has defined it and amounts to legislation rather than administrative regulation.

We further reply to the contentions of the Commissioner in this case just like the Board of Tax Appeals answered them in the PACIFIC FLUSH TANK COMPANY case, 45 B.T.A. No. 869, like the Court below answered identical contentions in this case, and like this Court answered substantially identical questions in the case of HELVERING v. CREDIT ALLIANCE CORPORATION, supra, and our further reply is this:— When a statute is plain and unambiguous a court will not resort to rules in aid of construction, but will give effect to the clear meaning of the statute. Subsection (a) (4) requires the inclusion in the "dividends paid credit" computation of amounts used or irrevocably set aside to pay or retire *indebtedness of any kind*. The language is plain and clear. There is no ambiguity or obscurity in it. It is susceptible of only one possible meaning. The purpose of the Congress has been expressed in language which anyone can understand. Therefore, under such circumstances, a court will not resort to rules of construction to give to such a statute a different meaning from that clearly expressed therein. The objections to the Commissioner's contention were succinctly stated by JUDGE HUTCHESON in the opinion below, as follows:

> "We think it clear that in attempting, by speculating as to what Congress intended to do except as that intent was expressed in the statute, to rationalize out of the section the comprehensive words which specifically grant the deduction, the Commissioner is attempting to have us arrogate to ourselves the function of rewording rather than of construing and applying the statute. The construction of a statute to make it carry out the intent its words import is one thing. The construction of it to bring it nearer to the thought of administrator or court, or of some particular section of public opinion, as to

what Congress intended or ought to have intended, or that the law would better serve its purpose if it were drawn that way, is quite another."

In 1938 the respondent paid $530,000.00 to retire "indebtedness" and it is mandatory under Subsection (a) (4) that such payment be included in respondent's "dividends paid credit" because the section covers all "indebtedness" except interest on obligations.

Replying specifically to the contention of the Commissioner that Subsection (e) of Section 27 is controlling over Subsection (a) (4) of Section 27 and hence bars the credit here claimed in 1938 for payment of indebtedness, we submit that in fact there is no relation between the provisions of Subsection (e) and Subsection (a) (4). This is shown by analysis of Subsection (e) and its application. Subsection (e) is comprised of two sentences. The first sentence provides the extent to which a dividend paid in obligations shall be used in computing the *basic surtax credit*. The basic surtax credit is defined by Subsection (b) and is included in the "dividends paid credit" by Subsection (a) (1) of Section 27. The second sentence of Subsection (e) provides the extent, if any, to which payments in the taxable year of dividend obligations issued after December 31, 1935, and before January 1, 1938, "shall be *treated as a dividend paid* in the taxable year when the redemption occurs." Dividends paid are includible in the "dividends paid credit" only through the basic surtax credit so this sentence also refers only to the basic surtax credit which, as pointed out above, is included in the "dividends paid credit" by Subsection (a) (1) and not by Subsection (a) (4). Nowhere in Subsection (e) is there any reference to what may or may not be included in the debts paid credit provided for by Subsection (a) (4). The basic surtax credit, of which the payment of dividends is a part, is one element of the "dividends paid credit" and is provided for by Sub-

section (a) (1). The debts paid credit is another element of the "dividends paid credit" and is provided for by Subsection (a) (4). Each of these elements would function as well and require no change in wording had the other not been enacted. They, therefore, are elements entirely independent of each other. Subsection (e), therefore, relates exclusively to Subsection (a) (1) through the definition supplied by Subsection (b) and does not control over or restrict what may be included in anything; but instead functions to broaden one element of the "dividends paid credit" namely, the "basic surtax credit," to include items which otherwise would not be includible in it. The fallacy of the Commissioner's position is in that he reads Subsection (e) as if it treats of the extent to which certain items are includible in the "dividends paid credit" instead of in the "basic surtax credit" as its language expressly states. We believe that the decision by the Board of Tax Appeals in this case and in SPOKANE DRY GOODS COMPANY, supra, as well as the decision of the Ninth Circuit in SPOKANE DRY GOODS COMPANY, supra, is occasioned by the fact that each of these courts failed properly to distinguish between "basic surtax credit" and "dividends paid credit." The court below recognized this distinction and necessarily held contrary to the other decisions.

If it be permissible to resort to rules of construction or delve into the cloudy realm of Congressional intent, we submit that since Subsection (a) (4) contains its own limitations, namely, the amounts paid must be reasonable with relation to the size and terms of the indebtedness and payments of interest on indebtedness are excluded, no other limitations or exceptions may be read into it as this Court is being asked to do. When Congress enacted Subsection (e) of the 1938 Act, it knew that there were many outstanding dividend obligations which would have to be paid because by Subsection (d) of Section 27 of the 1936 Act the Congress

had provided for the payment of dividends in corporate obligations and their inclusion in computing the "dividends paid credit" provided for by the 1936 Act. Had Congress intended that payments made in redemption of dividends obligations issued prior to 1938 should be excluded from Subsection (a) (4) as amounts used to pay indebtedness of any kind, it seems incredible that it would not have said so.

Moreover, the legislative history of Subsection (a) (4) shows that it was intended to apply to all kinds of indebtedness. The language was borrowed verbatim from Section 355 (b) of the REVENUE ACT OF 1937 (App. page 28). That subsection had its origin in Section 351 (b) (2) (B), Act of 1934, which provided for a credit in computing personal holding company tax of amounts due or set aside to retire indebtedness occurring prior to January 1, 1934, etc. When the Act of 1937 was being considered the Joint Committee on Tax Evasion and Avoidance recommended that said provision be eliminated entirely. (Report of Ways and Means Committee, 75th Congress, First Session, House Report 1546.) The Ways and Means Committee refused to follow this recommendation. The Senate not only agreed with the Ways and Means Committee that the provision should be retained, but broadened it by inserting the words "of any kind" between "indebtedness" and "incurred." (Section 355 (b), REVENUE ACT OF 1937.) The Finance Committee stated that a controversy had arisen as to the intent of the law and the amendment was made for the purpose of clarification. (Report of Senate Finance Committee, 75th Congress, First Session, Senate Report 1242.[2])

[2] The Committee recommends that Section 355(b) on page 9 of the Bill be amended as follows:

> "(b) Amounts used or irrevocably set aside to pay or retire indebtedness of any kind incurred prior to January 1, 1934, if such amounts are reasonable with reference to the size and terms of such indebtedness."

The respondent relies primarily on the statute itself in support of its position. Respondent also relies on the decision of the Board of Tax Appeals in PACIFIC FLUSH TANK COMPANY v. COMMISSIONER, 45 B.T.A. 869, and the decision of this Court in HELVERING v. CREDIT ALLIANCE CORPORATION, 316 U.S. 107, 62 S. Ct. 989. In the first mentioned case the taxpayer paid a bonus in 1937 in its 4 per cent notes, claimed the amount paid as a business expense deduction in its 1937 return and the Commissioner allowed the deduction. The notes were paid in 1938 and the taxpayer included the payment in computing its "dividends paid credit" for said year under Subsection (a) (4). The Commissioner disallowed the credit on the basis of Article 27 (a)-3 of REGULATION 101 which, as previously stated, provided that no credit may be allowed under Subsection (a) (4) for amounts used to pay or retire indebtedness which represents an item which is allowable as a deduction from gross income. The Commissioner argued that the Regulation was a reasonable interpretation of the statute in that the Regulation prevented a taxpayer from getting the benefit of a double credit or deduction for the same item. The Board of Tax Appeals held that the language of Subsection (a) (4) was plain and unambiguous and hence there was no occasion to apply rules in aid of construction. The Board accordingly held for the taxpayer. The Commissioner noted an appeal to the Circuit Court of Appeals for the Sixth Circuit from the decision of the Board in the PACIFIC FLUSH TANK COMPANY case, supra, but later the ap-

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The Committee agrees with the Ways and Means Committee of the House that the deduction (in arriving at the undistributed adjusted net income of a personal holding company) of amounts used or set aside to retire indebtedness incurred prior to January 1, 1934, should be retained in the bill. The insertion of the words "to pay" and "of any kind" are clarifying amendments to existing law. The word "irrevocably" is added to protect the revenue, so that amounts may not be set aside for retirement of debt, and deductions secured, although finally such amounts are never used to retire the indebtedness.

peal was dismissed on the Commissioner's own motion. (PRENTICE HALL, 1943, Par. 61085.) Said action on the part of the Commissioner may indicate that he agreed with the decision of the Board in said case. The Fifth Circuit Court of Appeals held in respondent's case that the Board by its decision in the PACIFIC FLUSH TANK COMPANY case, supra, reversed its earlier decision in the SPOKANE DRY GOODS COMPANY case, supra. It is true that the Board did attempt to distinguish the PACIFIC FLUSH TANK COMPANY case from the SPOKANE DRY GOODS COMPANY case, but in reality there is no material difference between the two cases. The deduction of the bonus paid in notes on the one hand and the credit for the dividend paid in obligations on the other, each resulted in diminishing the surtax on undistributed profits.

In HELVERING v. CREDIT ALLIANCE CORPORATION, supra, the question was whether the taxpayer was entitled to a "dividends paid credit" under Subsection (f) of Section 27 of the REVENUE ACT OF 1936. Since the dividend was not taxable to the recipient, the Commissioner contended that it was not allowable as a credit in view of Subsection (h) of Section 27 and he relied on TREASURY REGULATION 94, Article 27 (f). This Court held that the Regulation was invalid and that Subsection (f) must be given effect even though the distribution was not taxable in the hands of the recipient. MR. JUSTICE ROBERTS, who wrote the opinion, said:

> "We should, of course, read the two sections as consistent rather than conflicting, if that be possible. Here it is not only possible but begets no absurd or impractical results."
>
> "But whatever may be said of the policy behind the statute's provisions, we are not at liberty to disregard the direct and unambiguous language of Subsection (f)."
>
> "In view of what we have said as to the plain meaning of Subsection (f), we think that no complexity or confusion is discoverable, and that the regulation not only

was contradictory of the plain terms of the subsection, but attempted to add a supplementary legislative provision, which could only have been enacted by Congress."

In respondent's case an analogous situation exists. The credit claimed by respondent is allowable under the unambiguous language of Subsection (a) (4). The REGULATION (Article 27(a)-3, Reg. 101) on which the Commissioner relies to deny the respondent the "debt credit" contravenes the plain terms of Subsection (a) (4) and attempts to limit the effect of that subsection beyond any limitation which Congress itself saw fit to impose when the subsection was enacted, and it may fairly be said here too that the Regulation in question is an attempt to add a supplementary legislative provision which could only have been enacted by Congress.

Conclusion

The decision of the Fifth Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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APPENDIX

Opinion Court Below

Before Sibley, Hutcheson and Holmes, Circuit Judges

Hutcheson, Circuit Judge: Submitted upon stipulation as to the facts,[1] the Board, following its decision in Spokane Dry Goods Co. v. Commissioner,[2] sustained the determination of the Commissioner that in computing its income tax for the taxable year 1938, the taxpayer was not entitled under 27(a)(4),[3] to take a dividends paid credit for the $530,-

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[1] In 1937, taxpayer, a Delaware Corporation having two stockholders, Pure Oil Corporation and Sabine Towing Company, Inc., declared and paid on its outstanding common stock, cash dividends of $30,000, and a further dividend of $530,000.00 by the issuance and delivery of its 10 year 8% notes. In its Federal income and excess profits tax return for 1937 the petitioner reported the cash dividends and the dividends paid in its obligations, and they were allowed as dividends paid credits.* During the tax year, 1938, the year involved in this proceeding, the 10-year dividend notes were paid to its stockholders in cash and in its return for 1938, taxpayer reported these distributions to stockholders and claimed a dividends paid credit, under Sec. 27(a)(4), Revenue Act of 1938, on account of the sums used to pay and retire them. Respondent disallowed the claim and taxpayer brought the matter to the Board.

* Section 27 of Revenue Act of 1936:

Sec. 27. Corporation Credit for Dividends Paid.

(a) Dividends Paid Credit in General.—For the purposes of this title, the dividends paid credit shall be the amount of dividends paid during the taxable year. * * *

(d) Dividends in Obligations of the Corporation.—If a dividend is paid in obligations of the corporation, the amount of the dividends paid credit with respect thereto shall be the face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. * * *

[2] 43 B. T. A. 793, aff'd., 125 F. (2d) 865.

[3] Sec. 27. Corporation Dividends Paid Credit:

"(a) Definition in General. As used in this title with respect to any taxable year the term 'dividends paid credit' means the sum of: (1) * * * (2) * * * (3) * * * and (4) 'Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness.' As used in this paragraph the term 'Indebtedness' means only an indebtedness of the cor-

000 used to pay or retire the notes issued in 1937 as dividends paid on its obligation.

Taxpayer is here insisting, that by the plain mandate of the section it is entitled to the credit claimed and that both this and the Spokane case were wrongly decided. The Commissioner, standing on the Spokane case and on the regulation that case approved, insists that the order of the Board was right and must be affirmed. We do not think so. We think it clear that the Spokane case was wrongly decided by Board and court; that the dissenting opinion of Board member Hill, clearly and correctly stated the law of that case; and that in the Pacific Flush Tank case,[4] the Board while in terms differentiating, in effect overruled its prior decision. We agree with what it there said. "The terms of the statute as applicable to the facts of this case, are so plain and unambiguous as to require in our opinion no resort to construction in order to ascertain its meaning. However, if it could be said that the application of the literal meaning of the statute leads to results which should be avoided, that is, the granting of a double tax benefit, and that this statute should be construed in the light of the purpose and intent of Congress in enacting same, we nevertheless * * * conclude that even if the allowance of the credit claimed here would result in duplicating in whole or in part a tax benefit to the petitioner, it nevertheless appears clear that Congress intended to and did expressly grant such credit. And we further conclude that Art. 27 (a) (3) of Regulations 101, purporting to deny

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poration existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to and in existence at the close of business on such date. Where the indebtedness is for a principal sum, with interest no credit shall be allowed under this paragraph for amounts used or set aside to pay such interest."

[4] Pacific Flush Tank Co. v. Commissioner, 45 B.T.A. 69.

such credit is contrary to the statute and is therefore a nullity as applied to the facts of this case."

We think it clear that in attempting, by speculating as to what Congress intended to do except as that intent was expressed in the statute, to rationalize out of the section the comprehensive words which specifically grant the deduction, the Commissioner is attempting to have us arrogate to ourselves the function of rewording rather than of construing and applying the statute.[5] The construction of a statute to make it carry out the intent its words import is one thing. The construction of it to bring it nearer to the thought of administrator or court, or of some particular section of public opinion, as to what Congress intended or ought to have intended, or that the law would better serve its purpose if it were drawn that way,[6] is quite another. However, we need

[5] "Courts and Administrative agencies are bound to enforce the plain words of the statute although there may be reason to think in view of the general legislative purpose that some other provision would have met with favor, if the legislature had called it to mind." Commissioner of Internal Revenue v. Windrow, 89 F. (2d) 69, 110 A.L.R. 1251.

[6] "A legislative act in the United States is not as in some countries, a mere general outline by a party or group in power, of the purposes it wishes to accomplish, to be expanded, implemented and given effect by its administrators in accordance with the general purposes of its proponents. A fundamental fact in American political life has always been that in the struggle here for laws as means, to make law as liberator effective, there have always been differing opinions, as to the wisdom, propriety and scope of proposed new and controversial laws. Laws as finally enacted here, are usually the result of a compromise, or at least of an adjustment of these conflicting views.

"Because this is and always has been so, it can be usually said of our laws, that the general, not the partial or partisan will, speaks in them. It is because this is so, that canons of statutory interpretation and construction require that statutes must be construed and given effect, in accordance with the language chosen for the expression, of this compromise and adjustment of views, and not in accordance with the purposes or views, of either the proponents or the opponents of the legislation; which have not been given expression in the statute." Fleming v. Belo, 121 F. (2d) at 212-13, affd. June 9, 1942, —U.S.—.

not further labor the point here, for in Helvering v. Credit Allowance Association, April 27, 1942, —U.S.—, the Supreme Court, rejecting the same kind of reasoning as to a dividends paid credit claimed under Section 27(b) of the Revenue Act of 1936, and declaring invalid a regulation which contravened the plain terms of the statute, has set the matter at rest. Definitely reaffirming the principle that it is for the courts not to write but to enforce a statute, the court said: "But we cannot, as the Government suggests, read into the section, as it stood when the transaction took place, an intent derived from the policy disclosed by the subsequent amendment. We shall not burden this opinion by extended reference to the legislative history of the Act of 1936. It is enough to say that it is inconclusive and, to some extent, supports the arguments of both parties. But whatever may be said of the policy behind the statute's provisions, we are not at liberty to disregard the direct and unambiguous language of Subsection (f)." The principle there announced has controlling force here. Congress, for reasons of its own, in working out a compromise or adjustment, of the very controversial questions raised by the policy of, in effect, taxing corporations on dividends unpaid and of allowing them credits on those paid or what was regarded as the equivalent, drew the dividends paid statutes in the terms in which we find them. The taxpayer, conforming to the statute, paid dividends in its obligations in 1937. Still conforming to the statute it paid these obligations in 1938 and claimed the dividends credit the statute allowed, for the payment or retirement of "indebtedness of any kind." It is not for the Commissioner or the courts to deny the taxpayer the deduction that Congress has granted him. The order is reversed and the cause is remanded for further and not inconsistent proceedings.

Reversed and remanded.

Dissenting Opinion—Spokane Dry Goods Company Case.

HILL, dissenting: I do not agree with the conclusion in the opinion of the majority. Two premises are assumed in support of such conclusion. They are (1) that Section 27 (e) of the Revenue Act of 1938 specifically prescribes what dividends paid credits are allowable in respect of dividends paid in a corporation's obligations and that thereby the dividends paid credit provided by Section 27 (a) (4) of such act is excluded if the indebtedness involved represents a dividend obligation; and (2) that it should not be presumed that Congress intended to grant a double deduction for the same transaction in the absence of unmistakable and definite language evidencing such intent.

It is my conviction that the first premise is wrong. The second premise is sound in the abstract but, in my opinion, the situation here does not invoke its application.

I see nothing in the language or the subject treated in Section 27 (e) to indicate that the prevention of duplication of dividends paid credit was involved in the purposes of such enactment. It seems clear to me that the objectives of such enactment are merely to provide when and in what amounts dividends paid credits shall be allowed for dividends paid, such dividends being paid in the corporation's obligations (1) when such dividends are so paid and, (2) when the dividend obligations are redeemed, if the amount for which they are redeemed exceeds their fair market value at the time of the dividend payment. The scope of the provisions of Section 27 (e) is confined to the one purpose of assuring to the taxpayer credit or credits for dividends paid to the extent of the amount for which the obligations are redeemed. The specific and plain language used to express this limited purpose leaves no doubt of its meaning. Neither Section 27 (e), *supra*, nor 27 (d) of the Revenue Act of 1936 relates to dividends paid

credit provided by Section 27(a) (4), *supra*, on account of money used or irrevocably set aside to pay or retire indebtedness. Neither Section 27(e) nor Section 27(d) purports to exclude the application of the provisions of Section 27(a) (4) where the indebtedness involved represents a dividend obligation. Neither of such sections touches the subject of duplicate credits, either specifically or by implication. The Revenue Act of 1936 has no provisions comparable to those of Section 27(a) (4) and consequently Section 27(d) thereof was enacted without reference to such provisions. Section 27(e), *supra*, is in essence merely a reenactment of such Section 27(d). Section 26(c) (1) and (2) of the Revenue Act of 1936 provides credits to corporations for purposes of surtax in the case of contracts restricting payment of dividends and contracts requiring earnings and profits to be paid or irrevocably set aside within the taxable year for the discharge of a debt. Section 26(c) (3) of that act prohibited the allowance of double credits in respect of such contracts. The provisions of such Section 26(c) (1), (2), and (3) were not carried forward to or reenacted in the Revenue Act of 1938 and no provisions comparable thereto appear in the latter act.

The provisions of Section 27(a) (4) first appeared in the 1938 Act. Its language is all-embrasive and unambiguous in providing dividends paid credit for payment of indebtedness as therein defined. By its terms it applies to such "indebtedness of any kind." There is no exception. Section 27(a) (4), on the one hand, and Section 27(e) and Section 27(d), *supra*, on the other, treat of and specifically provide for different, noninterdependent, and nonexclusive sources of dividends paid credit. There is nothing in the language of either of such sections or elsewhere in the Revenue Act of 1938 to indicate that if a dividends paid credit is taken for dividends paid in the corporation's obligations a dividends

paid credit may not also be taken as provided by Section 27(a)(4) when such obligations are paid, provided such obligations constitute indebtedness as defined in Section 27(a)(4). The obligations paid in 1938 by petitioner for which it claims a dividends paid credit in this proceeding constitute such indebtedness.

The credit in question is affirmatively authorized by unambiguous provisions of statute. The lack of ambiguity in the statute forecloses the privilege, assumed in the opinion of the majority, to construe it.

"It is elementary that the province of construction lies in the domain of ambiguity, and that the use by a legislative body of words having definite meanings creates no ambiguity, and that such words are to be taken and understood in their plain, ordinary and popular sense." Helvering v. Nebraska Bridge Supply & Lumber Co., 115 Fed. (2d) 288 (40-2 U.S.T.C. Par. 9794).

Furthermore, it is doubtful whether the charge of duplicate credit can be sustained in respect of the credit here in question. The credit in 1936 for dividends paid in petitioner's obligations was applied against income not for the purpose of normal tax, but for the purpose of surtax on undistributed profits under Section 14 of the Revenue Act of 1936. There was no such credit in respect of normal tax. The Revenue Act of 1938 has no provision for tax corresponding to the tax imposed by Section 14 of the 1936 Act. The credit in question here applies only to the tax provided by Section 13 of the Revenue Act of 1938. It does not apply to any other tax-levying provision. The charge of duplicate credit must, therefore, apply only in respect of the tax levied under Section 13 of that act. That section does not levy a surtax but levies a tax of 19 per cent on the adjusted net income of corporations generally. If a corporation has received dividends in the taxable year from domestic corporations it gets a credit

against tax of 16½ per cent of 85 per cent of such dividends. If it has a dividends paid credit consisting of one or more of the items constituting such credit as provided in Section 27, it gets a credit against tax of 2½ per cent of such dividends paid credit.

A comparison of the Revenue Acts of 1936 and 1938 discloses that not only are the credits allowed corporations under Sections 26 and 27 of the 1936 Act widely variant in scope and kind from credits provided in Sections 26 and 27 of the 1938 Act, but they are applied differently and under radically different schemes or plans of taxation.

The Revenue Act of 1936 levied both a normal and a surtax on corporations generally. The rate of the normal tax levied was graduated through four brackets from 8 per cent to 15 per cent on the normal tax net income. The rate of the surtax levy was graduated through five brackets from 7 per cent to 27 per cent on the undistributed net income. The credit which petitioner received for dividends paid in 1936 was a deduction from income for the computation of surtax only. It had no application to the normal tax levied. The credit that petitioner claims in this proceeding would, if allowed, be applied not as a deduction from income or in respect of a tax levied on undistributed profits, but to the extent of 2½ per cent thereof as a credit against a tax on the adjusted net income of corporations generally, regardless of whether any of such income was undistributed.

The two credits—the one received in 1936 and the one now claimed—were not credits against the same thing. One was against income, the other against tax. They were not the same kind of credits. One was for dividends paid and the other for indebtedness paid. They were not credits in respect of the same kind of tax or under the same or a comparable scheme of taxation. One credit was applied to the extent of its full amount, the other to the extent of only 2½ per cent of its amount. The credit in 1936 may have eliminated a surtax

entirely or it may have reduced the rate of surtax from 27 per cent to 7 per cent or to some intermedite rate, while the credit claimed in this proceeding would reduce a normal tax levy by the amount of 2½ per cent of such credit.

An attempt to detail all of the variances between the two credits which would be revealed in their application under the respective revenue acts would present a problem in permutations.

Who, then, can say that the credit claimed by petitioner in this proceeding duplicates the dividends paid credit received in 1936? If there is a duplication, how can the extent of it be calculated?

However, whether or not the allowance of the credit claimed here by petitioner would result in duplicating a credit which it took for the year 1936, it appears to me clear that the Congress intended to and did expressly grant such credit as is here claimed. The language providing such credit is unambiguous and, without reading something into the statute as it stands or imputing to it a more restricted meaning than its language warrants, I think it must be concluded that petitioner's claim of credit is authorized and should be allowed. Black and Harron agree with this dissent.

Section 13 of Revenue Act of 1938:

SEC. 13. TAX ON CORPORATIONS IN GENERAL.

(a) Adjusted Net Income—For the purposes of this title the term "adjusted net income" means the net income minus the credit provided in Section 26(a), relating to interest on certain obligations of the United States and Government corporations.

(b) Imposition of Tax.—There shall be levied, collected, and paid for each taxable year upon the net income of every corporation the net income of which is more than $25,000

(except a corporation subject to the tax imposed by Section 14, Section 231(a), Supplement G, or Supplement Q) a tax computed under Subsection (c) of this section or a tax computed under Subsection (d) of this section, whichever tax is the lesser.

(c) General Rule—The tax computed under this Subsection shall be as follows:

(1) A tentative tax shall first be computed equal to 19 per centum of the adjusted net income.

(2) The tax shall be the tentative tax reduced by the sum of—

(A) 16½ per centum of the credit for dividends received provided in Section 26(b); and

(B) 2½ per centum of the dividends paid credit provided in Section 27, but not to exceed 2½ per centum of the adjusted net income.

Section 27(a), (b) and (e), Revenue Act of 1938:

SEC. 27. CORPORATION DIVIDENDS PAID CREDIT:

(a) *Definition in General.* As used in this title with respect to any taxable year the term "dividends paid credit" means the sum of:

(1) The basic surtax credit for such year, computed as provided in Subsection (b);

(2) The dividend carryover to such year, computed as provided in Subsection (c);

(3) The amount, if any, by which any deficit in the accumulated earnings and profits, as of the close of the preceding taxable year (whether beginning on, before, or after January 1, 1938), exceeds the amount of the credit provided in Section 26(c) (relating to net operating losses), for such preceding taxable year (if beginning after December 31, 1937); and

(4) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness. As used in this paragraph the term "indebtedness" means only an indebtedness of the corporation existing at the close of business on December 31, 1937, and evidenced by a bond, note, debenture, certificate of indebtedness, mortgage, or deed of trust, issued by the corporation and in existence at the close of business on December 31, 1937, or by a bill of exchange accepted by the corporation prior to, and in existence at, the close of business on such date. Where the indebtedness is for a principal sum, with interest, no credit shall be allowed under this paragraph for amounts used or set aside to pay such interest.

(b) *Basic Surtax Credit.* As used in this title the term "basic surtax credit" means the sum of:

(1) The dividends paid during the taxable year, increased by the consent dividends credit provided in Section 28, and reduced by the amount of the credit provided in Section 26(a), relating to interest on certain obligations of the United States and Government corporations;

(2) In the case of a taxable year beginning after December 31, 1938, the net operating loss credit provided in Section 26(c)(1);

(3) The bank affiliate credit provided in Section 26(d).

The aggregate of the amounts under Paragraphs (2) and (3) shall not exceed the adjusted net income for the taxable year.

(e) *Dividends in Obligations of the Corporation.* If a dividend is paid in obligations of the corporation, the amount with respect thereto which shall be used in computing the basic surtax credit shall be the face value of the obligations,

or their fair market value at the time of the payment, whichever is the lower. If the fair market value of any such dividend paid in any taxable year of the corporation beginning after December 31, 1935, is lower than the face value, then when the obligation is redeemed by the corporation in a taxable year of the corporation beginning after December 31, 1937, the excess of the amount for which redeemed over the fair market value at the time of the dividend payment (to the extent not allowable as a deduction in computing net income for any taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs.

Section 355 of Revenue Act of 1937:

SEC. 355. UNDISTRIBUTED ADJUSTED NET INCOME.

"For the purposes of this title the term 'undistributed adjusted net income' means the adjusted net income (as defined in Section 356) minus—

* * *

"(b) Amounts used or irrevocably set aside to pay or to retire indebtedness of any kind incurred prior to January 1, 1934, if such amounts are reasonable with reference to the size and terms of such indebtedness."

Section 27(a), (d), (f) and (h) of Revenue Act of 1936:

SEC. 27. CORPORATION CREDIT FOR DIVIDENDS PAID.

(a) Dividends Paid Credit in General.—For the purposes of this title, the dividends paid credit shall be the amount of dividends paid during the taxable year.

(d) Dividends in Obligations of the Corporation.—If a dividend is paid in obligations of the corporation, the amount of the dividends paid credit with respect thereto shall be the

face value of the obligations, or their fair market value at the time of the payment, whichever is the lower. If the fair market value is lower than the face value, then when the obligation is redeemed by the corporation, the excess of the amount for which redeemed over the fair market value at the time of the dividend payment (to the extent not allowable as a deduction in computing net income for any taxable year) shall be treated as a dividend paid in the taxable year in which the redemption occurs.

(f) Distribution in Liquidation.—In the case of amounts distributed in liquidation the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913, shall, for the purposes of computing the dividends paid credit under this section, be treated as a taxable dividend paid.

(h) Nontaxable Distribution.—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this title for the period in which the distribution is made, no dividends paid credit shall be allowed with respect to such part.

Section 351 (b) (2) of Revenue Act of 1934:

"(2) The Term 'undistributed adjusted net income' means the adjusted net income minus the sum of:

* * *

(B) Amounts used or set aside to retire indebtedness incurred prior to January 1, 1934, if such amounts are reasonable with reference to the size and terms of such indebtedness;"

* * *

Article 27(a)-3. Regulations 101:

ART. 27(a)-3. AMOUNTS USED OR IRREVOCABLY SET ASIDE TO PAY OR TO RETIRE INDEBTEDNESS. (a) INDEBTEDNESS.—

Double credits are not permitted, either for the same year or for separate years. Thus, amounts which have been or may be properly taken as a credit pursuant to Section 27(e) of the Act or Section 27(d) of the Revenue Act of 1936 (both sections relating to dividends in obligations of the corporation) may not again be included in the dividends paid credit under Section 27(a)(4) when the obligations are paid. No credit may be allowed under Section 27(a)(4) for amounts used or irrevocably set aside to pay or retire indebtedness which represents an item which is allowable as a deduction from gross income, either for the same year or a different year. Thus the aggregate of the credits allowable under Section 27(a)(4) for amounts used or irrevocably set aside to pay or to retire obligations issued at a discount may not exceed the issue price of such obligations.

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SUPREME COURT OF THE UNITED STATES.

No. 518.—October Term, 1942.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Sabine Transportation Company, Inc.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[March 1, 1943.]

Mr. Justice Roberts delivered the opinion of the Court.

In this case the Circuit Court of Appeals held the respondent entitled to include in its dividends paid credit, pursuant to Section 27[1] of the Revenue Act of 1938, the amount paid to redeem notes given for dividends in a prior year.[2] The Circuit Court of Appeals of the Ninth Circuit had held to the contrary.[3] To resolve the conflict we granted certiorari.

In 1937 the respondent paid dividends, $30,000 in cash and $530,000 in its ten year eight per cent notes. As respects its liability for undistributed profits tax, it claimed and was allowed, pursuant to § 27(d) of the Revenue Act of 1936,[4] as part of its "dividends paid credit", the face value of the notes. In 1938 the respondent paid off the notes, and in its return for that year claimed the sum paid as a part of its "dividends paid credit" under the Revenue Act of 1938, § 27(a)(4).[5] The Commissioner's disallowance of the claim was sustained by the Board of Tax Appeals, but the Circuit Court of Appeals reversed the Board's decision.

The position of the petitioner is that the second credit claimed would duplicate the earlier one allowed and that § 27 of the Revenue Act of 1938 does not permit the duplication.

The Revenue Act of 1936, by § 13, imposed on corporations a tax ranging from eight to fifteen per cent of the so-called "normal-tax net income", consisting of net income less certain permitted

[1] Act of May 28, 1938, c. 289, 52 Stat. 447, 468.
[2] 128 F. 2d 945.
[3] Spokane Dry Goods Co. v. Commissioner, 125 F. 2d 865.
[4] 49 Stat. 1645, 1665.
[5] 52 Stat. 468.

deductions. It then laid a graduated surtax on "undistributed net income" which it defined as the adjusted net income (the normal-tax net income after credits) less the so-called "dividends paid credit". By § 27 the Act defined the latter as comprising dividends paid during the taxable year including [27(d)] dividends in obligations of the company to be reckoned at face value or market value, whichever was lower. The subsection also provided that, if such obligations were redeemed in any subsequent year, the excess of the redemption payment over the fair market value of the obligations as of the date of their issue should be treated as a dividend paid in the year of redemption.

The purpose of these provisions is clear and is a matter of common knowledge. Congress desired to encourage the payment of dividends so that the earnings of corporations might be subjected not only to normal tax as against the corporation, but also to taxation as income to the stockholders.[6] The means adopted was to relieve the corporation from surtax to the extent of dividends paid in cash or in obligations. The latter would be taxed to stockholders at their market value. If they were redeemed at a later year, at a figure above such value as of the date of their issue, the excess would be taxed to the holder as income to him in the year of redemption. Fairness dictated that in such case the corporation should have a further dividends paid credit for this excess of value paid by it.

The Revenue Act of 1938 adopted a different plan of corporate taxation. With respect to a corporation having the amount of income earned by the respondent, § 13 imposed a tentative tax of 19% of "adjusted net income", which was the entire net income less certain deductions not here material. This tentative tax was to be reduced by the sum of two deductions. One of these is not in issue here. The other is 2½% of the "dividends paid credit", not however to exceed 2½% of the adjusted net income. The dividends paid credit is defined by § 27. It consists of four items, two of which are carry-overs from previous years, which need not concern us; and two others which are important in this case,—first, the "basic surtax credit", § (a)(1), and, secondly, "amounts

[6] It appears that respondent's sole stockholders are two corporations, but we do not understand petitioner to contend that this circumstance affects the operation or application of Section 27. It is assumed that these two corporations are bona fide stockholders of respondent and paid tax on the dividends they received. The section in terms applies to every corporate taxpayer whether it has but two stockholders which are corporations or two thousand who are natural persons.

used . . . to pay or to retire indebtedness of any kind, if such amounts are reasonable with respect to the size and terms of such indebtedness," (a)(4).[7] Indebtedness is defined as indebtedness existing at the close of business December 31, 1937, and evidenced by bond, note, debenture, certificate of indebtedness, mortgage or deed of trust issued by the corporation and in existence at the close of business December 31, 1937, or a bill of exchange accepted prior to and in existence at that time. The term is further defined as covering principal only and not interest thereon.

The basic surtax credit is the sum of several items, including cash dividends paid and certain other specified credits. Dividends in kind are to be valued and treated as cash dividends. Subsection (e) provides that, in computing the basic surtax credit, a dividend paid in obligations of the corporation shall be treated as a cash dividend in the amount of the face value of the obligations or their market value, whichever is lower, and that, if the obligations are redeemed in a subsequent year, any excess paid the holders over the market value at date of issue shall be treated as a dividend paid in that year. This provision, it will be noted, is similar to § 27(d) of the Revenue Act of 1936. But the credit of which it forms a part differs from that of the earlier Act as it is against the tax and not against income and is limited to 2½% of adjusted income. The use of the credit, may, therefore, produce results materially different from the use of the credit granted by the 1936 Act.

The petitioner asserts that Congress did not intend the taxpayer to have two credits as a result of payment of a dividend in its own obligations, that exemptions or credits should be strictly construed as against the taxpayer, and that the regulations promulgated under the Revenue Act of 1938 clearly deny the deduction claimed in this case.

On the face of the 1938 Act the items which go toward making up the basic surtax credit under § 27(b) are distinct from the credit for indebtedness paid under § 27(a)(4). Although the note obligations paid by the respondent were issued in payment of dividends for a prior year they, nevertheless, fall within the precise terms of § 27(a)(4). In this connection § 27(e) might have application if the redemption of the notes had been at a figure less than their face or market value at the time they were

[7] No question is made in this case as to the reasonableness of the amount paid.

greater

issued to the stockholders for, in that case § 27(e) would have permitted the respondent to take a credit for the excess of the redemption price over the value at date of issue as a dividend paid in the current year. But we think that § 27(e) does not otherwise bear on a payment such as that in question and does not qualify the plain intent of § 27(a)(4).

The Congress had in the 1936 Act encouraged the payment of dividends in obligations. It knew that many corporations had done so. With this knowledge it adopted the sweeping language of § 27(a)(4) of the Act of 1938. As introduced the section spoke only of indebtedness. It was amended by the Senate Finance Committee by adding the words "of any kind" after the word "indebtedness", for the purpose of clarification.[8] These facts, without more, make plain the scope of the provision, and answer the contentions that no credit was intended to be granted for the payment in the taxable year of obligations issued for dividends in a prior year. If more were needed, it should be noted that had the corporation borrowed money in a prior year to pay a dividend, the payment of the debt in a later year would clearly have entitled it to credit for the payment under § 27(a)(4). There is no reason for assuming that Congress intended to treat the two cases differently, and it has, in plain terms, granted a credit in both.

What has been said respecting § 27(e) indicates that it does not limit or qualify § 27(a)(4). It may supplement it in a case where the payment of the obligations issued for dividends is in excess of the market value of those obligations when they were issued. The argument that it is a specific provision, qualifying an earlier general provision of § 27, must be rejected.

It remains to consider the Treasury Regulations promulgated under the 1938 Act.[9] These forbid a credit such as that claimed in this case, calling it a "double credit". We think the regulations are in the teeth of the unambiguous mandate of the statute, are contradictory of its plain terms, and amount to an attempt to legislate. They cannot prevail to preclude the credit claimed.[10] The judgment is affirmed.

MR. JUSTICE RUTLEDGE took no part in the consideration or decision of this case.

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[8] Senate Finance Committee Report, S. R. 1242, 75th Cong., 1st Sess.

[9] Regulations 101, Art. 27(a)-3.

[10] Helvering v. Credit Alliance Corporation, 316 U. S. 107.

Mr. Justice BLACK, with whom Mr. Justice DOUGLAS and Mr. Justice MURPHY concur, dissenting.

The taxpayer, Sabine Transportation Co., Inc., is a Delaware corporation doing business in Texas. Its stock is held in equal amounts by two other corporations, Sabine Towing Co., Inc., and The Pure Oil Corporation. In 1937, a dividend of $530,000.00 was declared, amounting to $35.33⅓ per share on the common stock. The dividend was paid to the two corporate owners by execution of ten year, eight per cent notes. The taxpayer then claimed and was allowed a "dividend paid credit" under the 1936 Act on its 1937 tax. In 1938 the taxpayer paid to its two corporate stockholders the full face value of the ten year notes. It is now given a second "dividends paid credit" under the 1938 Act on its 1938 tax.

This $530,000.00 has left the corporate treasury only once. Bookkeeping devices and paper contrivances should not be permitted to make two payments out of one; and if two deductions are permitted, why not three or more? The possibilities of manipulation of notes, bonds, stocks, and every other cash substitute imaginable, are particularly apparent when, as here, the taxpayer and its stockholders are so closely interrelated. Congress has passed no tax statutes which compel me to conclude that it intended to reward ingenuity in paper work by granting multiple tax deductions for a single money payment to discharge a single corporate obligation.